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Supreme Court of the United States

OCTOBER TERM, 1942.

FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION,

Petitioners.

VS.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA; ROSS B. THOMAS AND H. ISAIAH SMITH, WEST VIRGINIA STATE COURT RECEIVERS; BANKING COMMISSION OF WISCONSIN; CHARLES R. FISCHER, COMMISSIONER OF INSURANCE AND PERMANENT RECEIVER FOR DEBTOR CORPORATION IN AND FOR THE STATE OF IOWA; JOHN B. GONTRUM, INSURANCE COMMISSIONER OF THE STATE OF MARYLAND; DEWEY S. GODFREY, MISSOURI STATE COURT RECEIVER; L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE; AND SECURITIES AND EXCHANGE COMMISSION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF OF RESPONDENT, JOHN B GONTRUM, INSURANCE COMMISSIONER OF THE STATE OF MARYLAND.

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John B. Gontrum, Insurance Commissioner of the State of Maryland.

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TABLE OF CONTENTS

Citations.

Cases.

PAGES

Texts.

Statutes.

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OPINIONS BELOW.

The opinion of the District Court is printed in the record (R. 176-202) and is reported in 42 Fed. Supp. 973.

The opinion of the Circuit Court of Appeals for the Fourth Circuit is printed in the record (R. 238-263) and is reported in 129 Fed. (2d) 442.

The opinion of the District Court and the final order of the District Court approving the Debtor's petition were filed on January 5, 1942 (R. 175-176). The decree of the Circuit Court of Appeals reversing the District Court was entered on June 16, 1942 (R. 263-264). A petition for rehearing was filed on July 13, 1942 (R. 264-266), and was denied on July 22, 1942 (R. 267). The petition for certiorari was filed on August 20, 1942, and granted on October 12, 1942 (R. 286).

JURISDICTION.

The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code as amended (U. S. C. Tit. 28, Sec. 347(a)), and Sec. 24(c) of the Bankruptcy Act (U. S. C. Tit. 11, Sec. 47(c)).

STATUTES INVOLVED.

The statutes involved are Chapter X of the Federal Bankruptcy Act (U. S. C. Tit. 11, Secs. 501-676) relating to the reorganization of certain private corporations; the Federal Investment Company Act of 1940 (U. S. C. Tit. 11, Sec. 107(f), and Tit. 15, Secs. 80a-1 to 80a-52), relating to the federal regulation of so-called face amount certificate companies; Secs. 218 to 234 of Art. 48A of the Annotated Code of Maryland (1939 Ed.), Tit. "Insurance", Sub-Tit. "Installment Accumulation Contracts", relating to the regulation by the State of Maryland of the sale of so-called "face amount certificates" or "installment accumulation contracts"; and similar regulatory statutes of the States of Alabama, Delaware, Illinois, Iowa, Indiana, Kansas, Kentucky, Missouri, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and

Wisconsin. The particular sections of Chapter X of the Federal Bankruptcy Act and of the Federal Investment Company Act which will be relied upon in this brief will be printed in the argument. The pertinent Maryland statutes are printed as Appendix A to this brief. The other state statutes relating to the regulation of Fidelity Assurance Association are printed in Appendix D to the brief of the Securities and Exchange Commission.

STATEMENT OF THE CASE.

Fidelity Assurance Association, formerly Fidelity Investment Association, a corporation of the State of West Virginia with its principal office at Wheeling, West Virginia, for a number of years had been engaged in the business of selling a form of annuity contract somewhat similar to that issued by insurance companies. The company did business in 29 states, most of which had laws regulating the conduct of such business. In 15 states, including its home state of West Virginia, Fidelity was required to deposit securities with designated state officials to secure the payment of its liabilities on contracts issued in such states. As of the time of the institution of this proceeding, the value of these deposited securities was in excess of $20,000,000, about one-half of which amount was deposited with the State of West Virginia.

On December 31, 1940, Fidelity ceased issuing any contracts because it could not comply with the provisions of the Federal Investment Company Act of 1940 which took effect on January 1, 1941. On April 11, 1941, receivers were appointed for Fidelity by the Circuit Court of Kanawha County, West Virginia. The receivers took charge of the free assets of Fidelity, which amounted to something less than $1,000,000.00, and continued in charge until June 6, 1941, when Fidelity filed in the Dis-

trict Court of the United States for the Southern District of West Virginia a voluntary petition for reorganization under Chapter X of the Bankruptcy Act. On the same day, by *ex parte* order, the District Court undertook to require the immediate surrender to a trustee appointed by it, of the approximately $20,000,000 of securities which had been deposited by Fidelity with state officials. On June 10, 1941, again by *ex parte* order, the order of June 6, 1941, was amplified so as to be specifically directed against the state officials, who were designated by name and title.

None of the deposited securities were surrendered to the Trustee by any of the state officials. Some of the states filed answers controverting the allegations of the Debtor's petition and others filed motions to strike out and rescind the turnover orders of June 6 and June 10, 1941. Some states filed both answers and motions to strike out the turnover orders, and controversial answers and similar motions were also filed by creditors. The Insurance Commissioner of Maryland, who held a little less than $500,000 of securities which had been deposited with him by Fidelity as required by the laws of the State of Maryland, filed a motion to strike out the turnover orders, but did not file an answer controverting the allegations of the Debtor's petition.

The State of West Virginia and the West Virginia state court receivers had filed motions to strike out the turnover orders of June 6 and June 10, 1941, a few days after the entry of said orders, and after a brief hearing these motions were overruled, whereupon an appeal was entered to the Circuit Court of Appeals for the Fourth Circuit. While these appeals were pending the District Court heard argument on the similar motions of the State of Maryland and other states but it did not act immed-

iately on the motions. Instead, on motion of the trustee appointed by it, the District Court on August 9, 1941, amended its turnover orders of June 6 and June 10, 1941, by eliminating the provisions thereof requiring the various state officials to turn over the deposited assets to the Trustee for the Debtor, and in lieu thereof, enjoined the state officials from making any disposition of the deposited securities. The long (and needlessly involved) order of August 9, 1941, is printed in the record (R. 102-114). This action rendered moot the questions pending on appeal but the State of Maryland and other states promptly filed motions to strike out the injunction order of August 9, 1941 Argument was heard on said motions but the District Court did not act thereon until the conclusion of the hearing on the petition and controversial answers.

After an extended hearing over a period of several months, the District Court filed a lengthy opinion (R. 176-202) in which numerous objections to the jurisdiction of the court interposed by the respondents were considered and overruled. On January 5, 1942, the District Court entered an order (R. 175-176) approving the debtor's petition for reorganization and specifically overruling the motions to strike out the turnover orders of June 6 and June 10, 1941, and the injunction order of August 9, 1941. An appeal to the Circuit Court of Appeals for the Fourth Circuit was filed on March 12, 1942, and that Court, holding that the Debtor was an insurance company and also that the petition had not been filed in good faith, reversed the District Court and remanded the cause with directions to the District Court to dismiss the petition (R. 263-264).

While the Circuit Court of Appeals did not deem it necessary to pass directly upon the question of whether

the District Court had authority to enter the turnover orders of June 6 and June 10, 1941, or the injunction order of August 9, 1941, in view of its decision on the other points which were decisive of the case, nevertheless the question is presented to this Court inasmuch as the order of the District Court entered on January 5, 1942, from which the appeal was taken, not only approved the filing of the Debtor's petition but also specifically overruled the motions to strike out the turnover orders and the injunction order. Accordingly, the question of whether the District Court had authority to enter such orders will be argued in this brief.[1]

THE FACTS.

Inasmuch as a complete and comprehensive statement of the facts relating to Fidelity Assurance Association and this reorganization proceeding is contained in the Wisconsin-Iowa brief, it will not be necessary to make an extended statement of the facts in this brief. However, we do wish to point out and emphasize the facts relating particularly to the situation of this respondent and certain other vital facts and circumstances which we will especially rely upon in the argument in this brief.

Maryland Statute and Proceedings.

In Appendix D to its brief, the Securities and Exchange Commission purports to print the pertinent Maryland statutes (S. E. C. Appendices, 41-44). However, the Securities and Exchange Commission has omitted

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[1] Even though the Respondents have not sought a review of the decision of the Circuit Court of Appeals, nevertheless they are not limited in the argument before this court to points decided by the Circuit Court of Appeals The entire record is before this court, and the Respondents may urge any legal grounds which will support the judgment of the Circuit Court of Appeals. *Lagnes v. Green*, 282 U. S. 531; *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U. S. 555; *Helvering v. Gowran*, 302 U. S. 238; *Le Tulle v. Scofield*, 308 U. S. 415; *Ryerson v. United States*, 312 U. S. 405.

to print all of the pertinent parts of the Maryland statute and we have, therefore, printed the same as Appendix A to our brief. In addition, because of its complete misunderstanding of the nature of the Maryland proceeding, the Securities and Exchange Commission has printed certain Maryland statutes (Sections 52 and 61 of Article 48A of the Maryland Code) which are applicable to the liquidation of insolvent or illegally conducted companies similar to Fidelity but which have no application whatsoever to the pending Maryland proceeding.

In April, 1941, Fidelity Assurance Association had no assets physically located in the State of Maryland which could have been taken possession of by a receiver. The only assets in the State of Maryland were the securities which had been assigned to and deposited with the Insurance Commissioner of Maryland and which were held in trust by him under the provisions of the Maryland statute. Consequently, when proceedings were instituted against Fidelity in West Virginia on April 11, 1941, the Insurance Commissioner of Maryland made no effort to institute receivership proceedings under Section 52 of Article 48A of the Maryland Code because there were no assets to be turned over to a receiver. The Maryland Insurance Commissioner, as Trustee, continued to hold the deposited securities and later the Circuit Court of Baltimore City, an equity court, in the exercise of its ordinary chancery powers assumed jurisdiction of, and supervision over the administration of the trust.

It will thus be seen that not only is there no receivership proceeding pending in Maryland but likewise there is no reorganization or rehabilitation proceeding, or any other kind of proceeding directed against the Fidelity Assurance Association. The only pending proceeding

is an ordinary chancery proceeding for the administration of a trust under the jurisdiction of the court. Under Maryland law the Trustee (the Insurance Commissioner of Maryland), in the management and final liquidation of the trust, is subject to the complete control of the Circuit Court of Baltimore City.

More than a year and a half has elapsed since the institution of this proceeding in the District Court. During that time some of the securities held by this respondent as trustee have been called for redemption and other securities have, at the request of the Trustee for the Debtor and pursuant to the order of the Circuit Court of Baltimore City, been sold. In this way approximately 36% of the trust assets held by this respondent have been liquidated and are now represented by cash.

Fidelity's Relations With the State of Maryland.

Pursuant to the provisions of Section 222 of the Maryland statute, Fidelity in 1932 *assigned to* and deposited with the Insurance Commissioner of Maryland certain securities having an approximate market value of $500,000. From time to time additional securities were assigned to and deposited with the Insurance Commissioner of Maryland by Fidelity and securities then held by him were thereupon surrendered to Fidelity. As of June 6, 1941, the securities in the possession of the Insurance Commissioner of Maryland had a market value of $470,806.25 and as of April 10, 1941, the net cash liability of Fidelity on its contracts held by persons then residing in Maryland was $492,552.24 and the reserve liability on these same contracts was $508,163.70 (Exhibit No. 48, R. 814). There is testimony in the record to the effect that there are 2080 such contracts held by persons now resident in the State of Maryland but the formal report and list of contract holders filed

with the District Court by the Trustee for Fidelity discloses only 1135 such contracts, with approximately the same reserve and cash surrender liabilities. The difference of 915 contracts represents those contracts which are delinquent and on which there is no present liability by Fidelity, but under the terms of which the contract holders have certain options, such as redating privileges, privilege to pay up arrearages and reinstate the contract, etc.

The petitioners and the Securities and Exchange Commission contend that on its books Fidelity kept accurate and separate accounts for the reserve funds of each series of contracts issued by it and that the books indicated what securities were purchased with the reserve funds of each series. These statements are misleading. It is true that the testimony developed that Fidelity maintained books showing such a segregation of reserve funds by series but none of the securities themselves were in any way earmarked and it does not appear that even on the books, particular securities could be identified as belonging to any one series where securities of the same issue may have been purchased from the reserve funds of two or more series.

In other words, the securities themselves were not identifiable with any particular reserve fund, and prior to the institution of an injunction proceeding by the Securities and Exchange Commission in the latter part of 1938 Fidelity had made no effort to segregate the securities deposited with each state in accordance with the outstanding contracts of each series in such state. It was only during the past few years and after the entry of the injunction order in December, 1938, that Fidelity made any attempt to segregate its state deposits by series (R. 634-635), and by that time the deficiency

in assets made segregation impossible (R. 608, 638). There is some testimony of efforts on the part of Fidelity in 1939 and 1940 to advise some state officials of a segregation by series of the securities deposited with such state officials (R. 754-756) but the record does not disclose that any effort was ever made to advise the Insurance Commissioner of Maryland of the segregation on the books of Fidelity (R. 754, 756), and the only direct evidence on this point is that the Insurance Commissioner of Maryland was not advised of the breakdown into series funds of either the deposited securities or of Fidelity's liabilities in the State of Maryland. See note at the bottom of the first page of Exhibit No. 79.

It should also be pointed out that even where Fidelity made some effort to advise state officials of the segregation of the securities by series funds, such advice was not given at the time of the deposit of the particular securities (R. 646-648, Exhibit 67) but the state officials were advised some months later and after they had accepted the securities as a general deposit without segregation by series. In addition there was not only no effort to advise contract holders that state deposits were to be segregated by series, but on the contrary each contract holder was given a booklet which called his attention to the fact that "the securities deposited with state authorities are subject to the requirements of the states with respect to all the contract funds of Fidelity Investment Association, and are not necessarily held for the sole benefit of the holders of these particular contracts." (R. 657, 765).

The securities deposited in Maryland are registered in the name of the Insurance Commissioner of Maryland as Trustee and under the provisions of the Maryland statute these securities were and are held by him "in trust,

as security for all the holders of contracts or other obligations * * * sold, negotiated, issued or accrued in said company in the State of Maryland". In no instance were the securities which were deposited in Maryland earmarked as belonging to any particular series. For instance, no securities were ever registered in the name of "Fidelity Investment Company in trust for Series B contract holders". On the other hand, in many instances the securities deposited with the Insurance Commissioner of Maryland were purchased by Fidelity specifically for the purpose of making such deposit and were caused by Fidelity to be registered initially in the name of the Insurance Commissioner of Maryland. Consequently the Insurance Commissioner of Maryland at the time the securities were deposited had no notice whether they had been purchased from general funds of Fidelity or from reserve funds allocated to one or the other of the various series of contracts issued by Fidelity.

Insolvency of Fidelity.

The Debtor in its brief makes the bland assertion that Fidelity is 90% solvent. The District Court fell into the same error. It is true that on the basis of schedules submitted by the Debtor, the assets of Fidelity (95% of which are deposited assets) amount to about 90% of the aggregate cash surrender value of Fidelity's outstanding contracts. These figures are, however, misleading both as to the value of the assets and as to the extent of the liabilities.

In preparing such schedules some effort was made to show the market value rather than the book value of securities which had a market value, but with respect to securities which had no readily ascertainable market value and with respect to the tangible assets of Fidelity,

book values were used in arriving at the total value of assets. No effort was made to appraise these assets and no testimony was offered as to their real value. The indications are that these assets, such as, for instance, the Home Office building at Wheeling carried on the books at $450,000.00, are worth very much less than their book value. Accordingly, while the record does not show the true value of all the assets, we may safely assume that it is less than the figure submitted by the Debtor and relied on by the District Court and by the Securities and Exchange Commission.

On the other hand, the liabilities are understated. In the first place, there is not the slightest warrant for using the cash surrender value of contracts as the measure of the liability of Fidelity to its contract holders. At the very least the contract liability of Fidelity is the reserve value of each contract.[2] The reserve liabilities exceed the cash surrender liabilities by $745,982.69 (see Exhibit 48, Tr. 1116). As a matter of fact the liability to the contract holders may actually be considerably in excess of this amount because the contract has been broken not by the contract holder but by Fidelity, and in measuring the damages for the breach of contract, a contract holder might not necessarily be limited to the reserve liability on the contract. In addition, these schedules do not indicate the extent of Fidelity's liabilities to persons other than contract holders, and we have no way of knowing what such claims may

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[2] This was recognized by the Securities and Exchange Commission in its brief filed as amicus curiae in the 1938 receivership proceeding involving Fidelity. *Hutchinson v. Fidelity Investment Co.*, 106 Fed. (2d) 431. At pages 34 and 35 of its brief as amicus curiae, the Securities and Exchange Commission objected strenuously to the use of the cash surrender values to measure liabilities and insisted that "the company's real liability is the actuarial reserve necessary to pay the contracts at maturity according to their terms", and that "the present existence of a liability equal to the entire actuarial reserve is indisputable".

amount to. The testimony does indicate that the Federal Government alone is asserting an income tax deficiency amounting to approximately a quarter of a million dollars (R. 1221, Exhibit 118).[3] Accordingly while the exact amount of the liabilities does not appear, it is clear that they are substantially in excess of the amount shown on the schedules submitted by the Debtor.

The record, therefore, does not support the statement that Fidelity as a whole is 90% solvent. On the contrary, the indications are that it is much less than 90% solvent although the Debtor has failed to show exactly what deficiency of assets there is.

The petitioners fall into the same error in making the statement (brief p. 46) that reserve funds A, B, C and D are solvent. As pointed out in the Securities and Exchange Commission brief (pp. 7, 8), securities were "sold" and moneys were "borrowed" on open account between the separate series funds. The Securities and Exchange Commission admits that the series funds which have inter-fund accounts payable are insolvent, and that "the solvency of other funds depends on the extent to which their inter-fund accounts receivable are collectible assets".

Even if on the books of Fidelity it should appear that one or more series funds were solvent, this would only be on the basis that all of the securities which had been purchased from the reserve fund of that series could be recovered and applied solely to the payment of the liabilities on that series of contracts. As we shall show later in this brief, such an assumption is clearly untenable.

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[3] An examination of the notice of the deficiency assessment, Exhibit 118, shows that the Commissioner of Internal Revenue has completely disregarded the series trust fund theory, and is assessing income taxes on the basis of the total income from all the securities, irrespective of series.

Contract Provisions as to Segregation of Reserve Funds.

The statement is made by the petitioners that the contracts of all series provide for the creation and maintenance of a separate reserve fund solely for the discharge of the liability upon the contracts of that series. This statement is incorrect. No such provision is contained in the special income contract, the special annuity contract or, the Series A contract. There is only one Series C contract outstanding (R. 492). The contracts which contain such a provision are Series B and D. It is true that all of the contracts contain a provision that a certain portion of the payments of each contract holder shall be set aside in a reserve fund which reserve fund shall be invested in approved securities and deposited in trust as required by the laws of the State of West Virginia. There is no indication, however, except as to the Series B and D contracts, that such reserve funds are to be kept separate solely for the discharge of liabilities under contracts of that particular series.

SUMMARY OF ARGUMENT.

I.

The basic, fundamental issue in this case is whether the state deposit statutes are valid and effective, or whether such statutes may be abrogated to the extent that they prevent or interfere with any plan of reorganization which the Debtor may desire to effect under the provisions of Chapter X. If not, this proceeding is at an end because the free or undeposited assets of the Debtor are negligible, and unless the state deposits can be seized by the bankruptcy court there is no possibility of reorganizing the Debtor. We contend that the state deposits are not subject to the jurisdiction and control of the bankruptcy court.

A. The state deposit statutes are valid regulatory laws enacted pursuant to the police power reserved to the states by the Tenth Amendment. These statutes provide for the creation of an actual trust for the benefit of citizens of the respective states, and although they provide for liquidation of the trust assets in certain contingencies, they are not mere insolvency statutes which would be superseded by the bankruptcy statutes.

B. Title to, as well as possession of the state deposits are in the various state officials, as trustees, and the state deposits therefore do not constitute property of the Debtor subject to the jurisdiction of the bankruptcy court. Accordingly the bankruptcy court has no authority to require the surrender of the state deposits or to enjoin the disposition thereof by the state officials pursuant to the provisions of the various state laws.

C. The state officials having possession of the state deposits are immune from the judicial process of the federal courts under the provisions of the Eleventh Amendment. Although the states perhaps have no pecuniary interest in the deposited securities, nevertheless they have seen fit to throw their cloak of immunity around the state deposits, and the turnover orders and the injunction order directed against the state officials in their capacity as such are therefore void.

D. Even though it were assumed *arguendo* that the state officials were not immune from the process of the federal court under the Eleventh Amendment and that the bankruptcy court had a discretionary power temporarily to enjoin the disposition of the deposited securities, nevertheless the federal courts, having a scrupulous regard for the rightful independence of state governments, should be extremely loathe to issue turnover orders or

injunction orders against state officials in cases like the present. The issuance of such orders by the District Court in the case at bar constituted an abuse of discretion, rather than a wise exercise of discretion.

II.

The petition of the Debtor was not filed in good faith within the meaning of Section 146(3) of Chapter X in that it is unreasonable to expect that a plan of reorganization can be effected.

A. The Debtor has not met the burden of proving that it is not unreasonable to expect that a plan of reorganization can be effected. On the evidence it is clear, and all parties virtually concede, that there is no real possibility of a rehabilitation of the Debtor as a going concern.

B. A "slow and orderly liquidation" is not a plan of reorganization within the meaning of Chapter X, but even if a plan providing for the creation of some sort of liquidating corporation to conduct a slow and orderly liquidation of the Debtor's assets could be considered a plan of reorganization within the meaning of Chapter X, nevertheless there has been no showing by the Debtor that any such plan is necessary or would be beneficial to contract holders, or that it is reasonable to expect that any such plan could be effected.

III.

The petition was not filed in good faith within the meaning of Section 146(4) of Chapter X because it appears that the interests of the creditors would be best subserved in the prior pending state court proceedings.

A. Since there is no hope of a reorganization of Fidelity, as distinguished from a liquidation, the so-called

"safeguards" of a Chapter X proceeding are not pertinent considerations.

B. A central administration by the federal court is not essential in order that an impartial investigation of the acts of the management of the Debtor can be made. Nor is there any necessity for a single administration of the Debtor's affairs in the federal court in order to settle any supposed problems of marshalling assets and of distribution, or in order to properly liquidate the assets of Fidelity. Liquidation can be accomplished just as efficiently and much more expeditiously in the pending state court proceeding.

C. A central administration is not necessary in order to determine the numerous questions alleged to exist with respect to the construction of the state statutes and the determination under state laws of the relative rights of the contract holders. Such questions of state law can best be determined by the state courts, and the federal courts should be extremely reluctant to undertake to construe and apply the state statutes.

ARGUMENT.

I.

THE STATE DEPOSITS ARE NOT SUBJECT TO THE JURISDICTION AND CONTROL OF THE BANKRUPTCY COURTS.

The basic, fundamental issue in this case is whether or not the statutes of the various states where Fidelity made deposits to secure contract holders are valid and effective, or whether such statutes are to be abrogated to the extent that they prevent or interfere with any plan of reorganization which a debtor may desire to effect under the provisions of Chapter X of the Bankruptcy Act. The question is fundamental because 95% of Fidelity's assets are deposited with the officials of fifteen

different states pursuant to the laws thereof and if these statutes are to be given effect, the deposited securities must be distributed in accordance with the laws of those states to the persons entitled thereto and it is futile to talk about reorganization of Fidelity either as a going concern, or by means of a "slow and orderly" liquidation through the federal court as a central administrative agency. Unless the federal court can ignore the state statutes and require the various state officials to surrender the securities in their possession to the Trustee for the Debtor this proceeding is at an end because the free, or undeposited assets of Fidelity are insignificant in comparison with its liabilities. Recognizing this fact, the Debtor, the Trustee and the Securities and Exchange Commission have from the very beginning sought to have the District Court secure the control and possession of the deposited securities. Without the deposited securities, there is nothing left to reorganize.

On the other hand, the states whose citizens are fairly well protected by adequate or nearly adequate deposits have resisted from the beginning all efforts to compel them to surrender the securities,[4] and it was for this reason that the State of Maryland and other states refused to comply with the turnover orders entered by the District Court on June 6 and June 10, 1941, and instead filed motions to strike out and rescind such orders, thereby immediately raising the fundamental issue of whether or not the state deposits were subject to the jurisdiction and control of the bankruptcy court. The Debtor, the Trustee, the Securities and Exchange Commission, and the District Court, while asserting the paramount authority of the bankruptcy court over the state

[4] Even the states where the deposits are wholly insufficient to secure the outstanding liabilities refused to surrender their deposits and none of them have at any time suggested that the well secured states give up their deposits.

deposits, have constantly endeavored to avoid a decision on the fundamental question of the validity of the state deposit laws. The District Court overruled a motion of the West Virginia respondents to strike out the turnover orders, and while an appeal from that order was pending in the Circuit Court of Appeals for the Fourth Circuit, and while the motions of the State of Maryland and other states to strike out the orders of June 6 and June 10, 1941, were pending and undisposed of, the District Court entered its amendatory order of August 9, 1941, thereby rendering moot the question then pending on appeal, at least for the time being.

Not until after the District Court had completed the hearing and had finally approved the Debtor's petition did it formally overrule the motions of the State of Maryland and other states (R. 175). A number of times during the course of the hearing the District Court disavowed any intention to interfere with any vested rights of contract holders in state deposits but postponed consideration of what, if any, vested rights there were. The District Court took the position that the construction of such state statutes, that is the determination of the effect thereof and whether any contract holders were secured thereby, and if so what contract holders, and the extent to which they were secured, were questions which the District Court and not the state courts would decide. Similarly the District Court, even after the turnover orders were modified on August 9, 1941, continued to assert the right to require the surrender of the state deposits in the future (R. 958). Thus, while giving lip service to the principle that the state deposit laws are valid, the District Court strikes at the very heart of the state statutes by its holding that the state deposits are subject to the jurisdiction and control of the bankruptcy

court. In the same way both the Debtor and the Securities and Exchange Commission, while even now stating that they do not contend that the state deposit laws are invalid or that they should not be given full effect, nevertheless assume a position completely contrary to such statements.

It seems futile for the Debtor to urge and the District Court to decide that it is reasonable to expect that a plan of reorganization of Fidelity can be effected, reserving for later determination the question of whether there will be any property to form the basis for a reorganization. It seems to us that it would have been much better had the District Court first determined the fundamental question of its authority over the state deposits, and then determined the question of whether Fidelity could be reorganized only in the event it concluded that it did have authority over the state deposits and could subject them to its control. In this way the extended hearing as to the feasibility of reorganization might have been avoided. Such was the procedure approved by the Circuit Court of Appeals for the Fourth Circuit in *Seaboard Terminals Corp. v. Western Maryland Railway Co.*, 108 Fed. (2d) 911, where the District Court first determined the question of title to property claimed by the debtor before undertaking to determine the question of whether it was feasible to reorganize the debtor.

We contended in the District Court and in the Circuit Court of Appeals and we contend now, (1) that the state deposit laws are valid and effective regulatory statutes enacted pursuant to the reserved powers of the states under the Tenth Amendment to the Federal Constitution; (2) that the securities deposited with various state officials do not constitute "property of the debtor" within the meaning of Chapter X of the Bankruptcy

Act; (3) that the state officials having possession of such securities are immune from the judicial process of the federal courts under the Eleventh Amendment to the Constitution; and (4) that even if it be assumed *arguendo* that the bankruptcy court has some measure of jurisdiction or control over the state deposits, the *ex parte* turnover orders of June 6 and June 10, 1941, and the injunction order of August 9, 1941, were an abuse of discretion.

1. The State Deposit Laws Are Valid And Must Be Given Full Effect By The Bankruptcy Courts.

By the Tenth Amendment to the Federal Constitution there is reserved to the several states, or to the people thereof, all powers not delegated to the United States by the Constitution nor prohibited by it to the states. Within the limits of the powers thereby reserved to them, the states are as independent of the federal government as that government within its sphere is independent of the states.

One of the most important of the powers thus reserved to the states is the police power, and it was in the exercise of the police power that the State of Maryland and other states passed statutes regulating the sale of installment accumulation contracts, a business affected with a public interest. Corporations issuing and selling such contracts could only do so upon compliance with the laws of the respective states in which they sought to do business. The statutes of the 29 states in which the Debtor transacted business vary widely in their specific provisions and it is not possible within the limits of this brief to refer to and discuss the statutes of all 29 of these states. Accordingly we will confine our discussion to the statutes of Maryland, although the general argument set out in this portion of our brief is

applicable, with perhaps some modifications, to at least the 15 states in which the Debtor made deposits to secure its contract holders.

The statute passed by the State of Maryland provides in detail for the regulation of the business conducted by companies selling such contracts, and probably the most important regulatory provision is that requiring the assignment and deposit of *approved securities* to be held *in trust* by the state for the benefit of the persons designated in the statute. The Maryland statute is therefore a declaration of a public policy; a statute passed by a sovereign state in a valid exercise of its police power. The police power to pass such legislation is one undoubtedly reserved to the States by the Tenth Amendment to the Federal Constitution. It is a power which never has been, and never can be, delegated to the federal government as long as we are to have a dual system of government—as long as there is to be an indestructible union composed of indestructible states.

The Maryland statute is not at all a mere liquidation or insolvency statute, and as such susceptible of being interpreted as legislation upon the subject of bankruptcies and thus falling within the powers expressly granted to the federal government. It is true that the Maryland statute does provide a method by which deposits made by such companies shall be liquidated in the event they become insolvent, but the primary purpose of the statute is much more than this. It is to provide security for the citizens of the state who deal with the company and purchase its installment accumulation contracts. It should also be noted that the Maryland statute is not merely a deposit statute. In other words, the Maryland statute does not merely provide for a deposit of securities to be held as collateral for the performance of the com-

pany's obligations; it provides expressly for a transfer of title from the company and the creation of an actual trust for the benefit of designated persons. Most state statutes providing for the deposit of securities by insurance companies have been held to create express trusts for the benefit of designated policy holders of the company, *American United Life Ins. Co. v. Fischer*, 130 Fed. 2d 643, and in Maryland this is undoubtedly the case because the statute in express terms provides for a transfer of title and possession, and in addition expressly provides that the securities so transferred shall be held "in trust" for the designated beneficiaries. Even apart from the express language of the Maryland statute, it is clear under Maryland law that an express trust was created. *Casualty Insurance Company's Case*, 82 Md. 535.

The incidental provision of the Maryland law providing, among other things, for the liquidation of certain *specific securities* held in trust, upon the happening of certain contingencies and for payment to a *definite group* of its citizens, is not to be confused with a statute requiring that the *general assets* of a foreign corporation be liquidated in Maryland courts for the benefit of Maryland creditors of such corporation. Such a law might be considered a law on the subject of insolvency and therefore superseded by the federal bankruptcy statutes. But such is not this case.

It is true that the Federal Constitution grants to Congress the express power to enact uniform laws on the subject of bankruptcies, but to hold that Congress, under such power, could grant to the federal courts the power to set aside state statutes on matters of public policy passed in the exercise of the police power would be to

set at naught the whole theory of state sovereignty.[8] Consequently, it has been held that the express powers conferred upon the federal government by the Constitution are always subject to the implied limitation that the Congress in the exercise of such powers cannot transgress upon the rights of sovereign states.

Thus, in *Ashton v. Cameron County District*, 298 U. S. 513, this Court, in holding the Municipal Bankruptcy Act invalid said: "The power 'To establish * * * uniform laws on the subject of Bankruptcies' can have no higher rank or importance in our scheme of government than the power 'to lay and collect taxes'. Both are granted by the same section of the Constitution, and we find no reason for saying that one is impliedly limited by the necessity of preserving independence of the States, while the other is not. * * * Like any sovereignty, a State may voluntarily consent to be sued; may permit actions against her political subdivisions to enforce their obligations. Such proceedings against these subdivisions have often been entertained in federal courts. But nothing in this tends to support the view that the Federal Government, acting under the bankruptcy clause, may impose its will and impair state powers—pass laws inconsistent with the idea of sovereignty." (298 U. S. 530, 531).[9]

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[8] It may well be doubted whether Section 67(f) of the Bankruptcy Act (U. S. C. Tit. 11, Sec. 107(f)) added by Sec. 29(b) of the Investment Company Act of 1940, is constitutional in so far as it declares that deposits of securities made by a face amount certificate company pursuant to state law, shall be voidable as against the Trustee of the Debtor and to the extent it authorizes the Trustee to take possession of the securities. The question is not directly involved here inasmuch as Section 67(f) by its terms applies only to deposits to secure face amount certificates sold after January 1, 1941. In addition, it should be noted that the statute requires the Trustee for the Debtor to keep the deposited assets segregated and to distribute the proceeds thereof to the creditors entitled thereto under the provisions of the state laws.

[9] In *United States ~~v. Bekins~~*, 304 U. S. 27, a similar statute was upheld, but the Supreme Court did not overrule the *Ashton* case and pointed out that in enacting the new law Congress was careful to avoid the objections to the previous statute set out in the opinion in the *Ashton* case.

And see *Hopkins Federal Savings and Loan Association v. Cleary*, 296 U. S. 315, 337.

The District Court, relying upon an article by Professor A. H. Feller entitled "The Tenth Amendment Retires", published in the April, 1941, issue of the American Bar Association Journal, assumed that the *Cleary* and the *Ashton* cases were overruled by this Court in *United States v. Darby Lumber Co.*, 312 U. S. 100. We respectfully submit that this Court has not done away with the Tenth Amendment as an effective precept in American Constitutional Law, as the title of Professor Feller's article would seem to imply, nor has this Court overruled the *Cleary* and *Ashton* cases, or the principles therein stated. Nowhere in its opinion does this Court refer to these two cases, and certainly there is nothing said in the opinion which questions the principles enunciated in them. In the *Darby* case no question of conflict between federal and state statutes was involved, but here the question involved is whether the power conferred upon Congress to establish uniform laws on the subject of bankruptcies is subject to the implied limitation that it must not unduly restrict or limit the exercise of their police power by the states, just as the power of Congress to levy and collect taxes is subject to the implied limitation that they shall not be a direct burden on the states. We respectfully submit that the bankruptcy power is subject to such a limitation.

The District Court in its opinion says: "The only respect in which the state statutes can be said to conflict with the Bankruptcy Act is that they give to state officials the right to retain custody of the deposits until final settlement or redemption of the Debtor's liabilities. If such provisions are in conflict with Chapter X of the Bankruptcy Act (a question which I do not deem it nec-

essary to decide at this time) * * * the provisions of the Bankruptcy Act must be held to be 'paramount to any state statute the effect of which may be to impair or emasculate them' ". (R. 201). In other words, it is claimed that the powers granted to the federal courts under the Bankruptcy Act are sufficient to enable them to override the plain provisions of the Maryland statute, the validity of which is not questioned. It is our contention that no such power is conferred by the Bankruptcy Act and that if Congress attempted to confer such a power upon the bankruptcy court, the statute would be in direct violation of the Tenth Amendment.

For these reasons we respectfully submit that the state deposit laws are valid and must be given full effect in the bankruptcy courts.

2. The Securities Deposited With The Various State Officials Do Not Constitute Property Of The Debtor.

It is our contention that the securities deposited with the various state officials do not constitute property of the Debtor, and hence are not subject to the jurisdiction and control of the bankruptcy court. For this reason the District Court had no authority to enter the turnover orders of June 6 and June 10, 1941, or the injunction order of August 9, 1941. However, the District Court held that "the assets deposited with the states remain assets of the Debtor and the maximum extent of the interest of the states in those deposits is that they be held in custody until the liabilities of the Debtor are redeemed or settled" (R. 200), that the various state officials are not adverse claimants, and that "the assertion of adverse claims, being merely assertion, and no more, may be disposed of summarily, as I have done" (R. 202). In other words, the District Court has decided that the cash and securities held by the Insurance Commissioner

of Maryland constitute property of the Debtor within the meaning of Chapter X of the Bankruptcy Act, and as a matter of fact it so declared expressly in the order of August 9, 1941, recognizing that otherwise there would have been no foundation whatsoever for the injunction.

Since this is a proceeding under Chapter X of the Bankruptcy Act, the power and jurisdiction of the District Court to enter the turnover orders and the injunction order must be found in some provision of that Act. The only provision relied upon by the petitioners is Section 111 (U. S. C. Tit. 11, Sec. 511), which provides that the bankruptcy court "shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located". Consequently if the District Court had jurisdiction to enter the turnover and injunction orders, it must be on the ground that the securities held by the Insurance Commissioner of Maryland constitute "property of the Debtor" within the meaning of this section of the Act. We contend, however, that this is not true.

It must be borne in mind that the securities are not held merely as a pledge to secure the repayment of obligations of the Debtor to its contract holders. The Maryland statute shows clearly that title, as well as possession, is in the Insurance Commissioner of Maryland as the agent of the State of Maryland. The Maryland statute (Section 222) provides not merely that securities must be "deposited" with the Insurance Commissioner, but that such securities must be "assigned to" the Insurance Commissioner. This was done, and the securities are registered in the name of the Insurance Commissioner of Maryland as Trustee, so that unquestionably the legal title is vested in the Insurance Commissioner, and not in the Debtor.

It is also clear that not only is the legal title vested in the Insurance Commissioner of Maryland, but the equitable title to the cash and securities is likewise not vested in the Debtor, because the Maryland statute expressly provides that the "securities so assigned to and deposited with the Insurance Commissioner of Maryland shall be held by him in trust, as security for all the holders of contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued in said company in the State of Maryland."

In other words, the Maryland statute contemplates and requires the creation of an active trust in which the Insurance Commissioner of Maryland is the Trustee and the Maryland contract holders are *cestuis que trust* or beneficiaries. The legal title is in the Trustee, and the equitable owners of the securities are the Maryland contract holders. So long as there was no default, the Debtor was entitled to receive the income from the securities (Section 224), but upon default it lost even that right and had left to it only the right to receive any surplus that might remain after the securities had been sold and all obligations to contract holders in the State of Maryland had been paid in full. This bare right to receive such surplus, if any, does not constitute the securities themselves the property of the Debtor. In the first place, the interest of the Debtor in these securities is merely that of another beneficiary or *cestui que trust*, and as such it has no title or property right in the securities constituting the *res*. In addition, even this interest of the Debtor is subordinate to that of its Maryland contract holders, and the trust assets are not even subject to the expenses of administering the general assets of the Debtor. *Casualty Insurance Company's Case*, 82 Md. 535. Under such circumstances, how can it be said

that the securities constituting the trust *res* are the property of the Debtor? The Debtor was no more the owner of these securities than the settlor of a conventional trust is the owner of the property transferred by him in trust even though he might also be a beneficiary of the trust.

The situation is not at all the same as that existing where securities are pledged to secure a debt and the creditor has merely a lien upon the property. Even in such a case it might well be doubted whether such securities would constitute "property of the debtor" within the meaning of the Bankruptcy Act (see *In re Patten Paper Co.*, 86 Fed. (2d) 761), but it is not necessary for us to go that far in the present case because here the Maryland statute has clearly and explicitly created an express trust, has designated a Trustee, and has accurately and fully described the beneficiaries of the trust. It would therefore seem clear from a mere reading of the Maryland statute that the securities held by the Insurance Commissioner of Maryland do not constitute "property of the debtor".

There are several cases which support this contention and in so far as we are aware there are no authorities which hold that under a similar state of facts securities so held in trust would constitute "property of the debtor".

In the case of *In re Prudence Co.*, 82 Fed. (2d) 755, (cert. den., 298 U. S. 685), securities were deposited with trustees to secure bonds issued by the creator of the trust. An affiliated corporation guaranteed payment of the bonds and under the trust indenture had the right to service the securities constituting the trust *res* and collect the income therefrom so long as no default occurred in the bonds. Securities constituting the trust *res* had

originally belonged to the guarantor of the bonds and had been transferred by it to the corporation which created the trust and issued the bonds. A default occurred in the bonds and subsequently reorganization proceedings under the Bankruptcy Act were instituted against both corporations. The trustee appointed in the reorganization proceedings for the guarantor corporation asserted that as between it and its affiliate which had issued the bonds, the securities constituting the trust *res* belonged to the guarantor corporation. He therefore sought and obtained from the bankruptcy court an injunction restraining the trustees designated in the trust indentures from disposing of or taking any other action with respect to the securities constituting the trust *res*. The Second Circuit Court of Appeals held that even though the title of the guarantor corporation be assumed to be superior to that of the corporation which had issued the bonds, nevertheless, since a default had occurred, the guarantor corporation had lost all rights in the securities under the terms of the trust indentures, and therefore the Bankruptcy Court had no jurisdiction to enjoin or restrain the trustees from performing the duties imposed upon them by the respective trust indentures.

Warder v. Brady, 115 Fed. (2d) 89, is exactly in point. There a trustee for a debtor in a reorganization proceeding sought to obtain possession of certain monies which, pursuant to the order of a state court in a prior receivership proceeding, had been deposited by the debtor in a sinking fund to secure the repayment of certain obligations. The Fourth Circuit Court of Appeals, in holding that the sinking fund did not constitute property of the debtor, said: "A sinking fund under a bond mortgage is a trust fund, the title to which passes from the debtor

to the trustee who holds it for the benefit of the bondholders." See also: *Seaboard Terminals Corporation v. Western Maryland Railway Co.*, 108 Fed. (2d) 911.

The situation is not at all the same as that presented to this Court in *Continental Illinois National Bank and Trust Co. v. Chicago, R. I. & P. R. Co.*, 294 U. S. 648, so strongly relied upon by the Debtor in the Circuit Court of Appeals. There this Court upheld an injunction restraining the Reconstruction Finance Corporation and certain banks from disposing of securities held by them as collateral for the payment of obligations of the debtor corporation, but it appeared that the value of the securities held as collateral exceeded the debtor corporation's obligations secured by the collateral, by $28,000,000 in one case and $10,000,000 in another case. As a matter of fact the total value of all collateral was more than three times the total amount of the debtor corporation's obligations secured by the collateral. This Court held that the injunction was proper and necessary in order to protect these equities of $38,000,000 which equities, as this Court pointed out, constituted property of the debtor.

In the *Rock Island* case the assets in question were merely pledged and title thereto remained in the debtor corporation subject to a lien; here title to the assets in question passed completely from the Debtor prior to bankruptcy and was then and is now vested in a trustee. There the debtor corporation had a tremendous equity in the assets in question since the liens against the same amounted to less than one-third of the value of the assets; here the Debtor has no equity whatsoever in the trust assets and the value of the assets is actually less than the Debtor's obligations, the payment of which they secure. In the *Rock Island* case the injunction was upheld as a temporary measure to grant the debtor a reasonable

delay and opportunity to satisfy its obligations without a forced sale of the collateral; in the case at bar the court has not only enjoined a sale or other disposition of the trust assets, it has also declared that such trust assets constitute property of the Debtor. Certainly the *Rock Island* case is no authority for such action.

We also submit that the decision of the Circuit Court of Appeals for the Second Circuit in *Re Central Funding Corporation*, 75 Fed. (2d) 256, cited by the Debtor, is not pertinent. That case involved a turnover order entered after the approval of a plan of reorganization which was binding upon the beneficiaries of the trust and which provided for a termination of the trust. The order was entered pursuant to Section 227 of Chapter X which authorizes the court to require the execution of such instruments as may be necessary to effect a transfer of property dealt with by a plan which has been confirmed. In other words, the debtor and the beneficiaries of the trust entered into an agreement with respect to their mutual rights, which agreement provided for a termination of the trust and a transfer of the trust property to the debtor. The court merely required the trustee, who had no further interest in the trust property, to surrender the same in accordance with the plan. That is, of course, far different from the situation in the case at bar.

We respectfully submit, therefore, that the cash and securities held in trust by the Insurance Commissioner of Maryland for the Maryland contract holders of the Debtor do not constitute property of the Debtor. While we have been discussing this point primarily in connection with the Maryland statute, the same reasoning applies to the statutes of the other states, and it is our contention that none of the deposited securities consti-

tute property of the Debtor. This being so, the bankruptcy court has no jurisdiction or control over the deposited securities and not only can it not require the state officials to turn over the same to the trustee appointed in this proceeding, but neither can it enjoin the state officials from disposing of the deposited securities in accordance with the laws of their respective states.

3. The State Officials Having Possession Of The State Deposits Are Immune From The Judicial Process Of The Federal Courts Under The Eleventh Amendment To The Federal Constitution.

The Eleventh Amendment to the Constitution of the United States provides that "the Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State or by Citizens or subjects of any Foreign State". The respondents contend that this provision of the Constitution is a direct prohibition against any suit or action, or other proceeding or order, summary or plenary, in the District Court or any other federal court to take possession of or exercise authority over the securities heretofore deposited with officials of the various states. On the other hand the petitioners contend that the Eleventh Amendment is not applicable because the turnover orders and the injunction order are not directed against any state as such, but only against the state officials as individuals.

It is true that these orders were not directed against any State by name and were directed only against certain named state officers, but they were directed against such state officers in their official capacities and the Eleventh Amendment covers "not only suits brought against a state by name, but those also against its officers, agents and representatives, where the State, though

not named as such, is nevertheless the only real party against which alone in fact the relief is asked, and against which the judgment or decree effectively operates". *Ex Parte Ayers*, 123 U. S. 505, 506. It has long been settled that the Eleventh Amendment will bar the action where the State officer or agent named as defendant has no personal interest in the controversy but is acting solely for and on behalf of the State. See *Louisiana v. Jumel*, 107 U. S. 711; *Cunningham v. Macon & Brunswick R. R. Co.*, 109 U. S. 446; *Hagood v. Southern*, 117 U. S. 52; *Murray v. Wilson Distilling Co.*, 213 U. S. 151; *Worcester County Co. v. Riley*, 302 U. S. 292; and *Read v. National Equity Life Insurance Co.*, 114 Fed. (2d) 977.

In the present case the State of Maryland, by valid statute, heretofore required the Debtor to assign to and deposit with the Insurance Commissioner certain securities to be held, in the language of the statute, "in trust, as security for all the holders of contracts or other obligations heretofore or hereafter sold, negotiated, issued, or accrued in said company in the State of Maryland". While the State of Maryland itself has no direct pecuniary interest in the securities so assigned to and deposited with the Insurance Commissioner, the legal title to said securities has passed from the Debtor and is now in the State of Maryland, or its agent the Insurance Commissioner, as Trustee for certain citizens of Maryland. The purposes of the trust are explicitly set forth in the statute, and the persons who are the beneficiaries thereof are clearly designated. The Trustee (the State of Maryland, or its Insurance Commissioner) has legal title and possession of the securities, and clearly, therefore, any action to obtain possession of the securities must be directed against the Insurance Com-

missioner, not in his private or individual capacity, but in his capacity as an agent of the State of Maryland. This being the case the State of Maryland is the real party defendant.

This proceeding was instituted by the Debtor and the action of the Court in requiring the Insurance Commissioner of the State of Maryland to turn over, and in enjoining him from selling or otherwise disposing of the securities now held by him must necessarily be predicated upon the contention that the securities constitute property of the Debtor. But the title in the Debtor thus asserted is here disputed, and title to the securities in question is claimed by the Insurance Commissioner of the State of Maryland not as an individual, but as an officer of the State of Maryland. It is not possible to assert title in the Debtor without controverting the title of the State of Maryland and its officer. Since the State of Maryland, through its officer, has possession, any action to take possession away from it or to interfere with such possession is directed against the State of Maryland as the real party in interest. It is not necessary, ~~in order~~ to assert immunity from suit, that the State hold title for its own benefit. It is enough that title is in the State, or its officer, even though held by it or him as Trustee for the benefit of others. *Cunningham v. Macon & Brunswick R. R. Co.*, 109 U. S. 446.

Lankford v. Platte Iron Works, 235 U. S. 461, and the companion case of *Farish v. State Banking Board*, 235 U. S. 498, are squarely in point. There the State of Oklahoma had provided by statute for the creation of a depositors' Guaranty Fund to be sustained by contributions required to be paid by the banks in the State, the Fund to be disbursed for the purpose of liquidating deposits of failed banks. Administration of the Fund

was committed to the Oklahoma State Banking Board, and certain depositors of a failed bank filed suit in the federal court to require the Banking Board to pay their claims. This Court dismissed the action on the ground that the State Banking Board was immune from suit under the Eleventh Amendment, even though the contention was made that the Fund was not under the executive or legislative control of the State, and could be used solely for the purpose of paying depositors of failed banks; in other words, that the Fund was held in trust for private persons and the State had no pecuniary interest in it. This court held, however, that even if the Fund were not a State Fund, it was at least a Fund under the management of the State, through its officers, and that the federal court had no jurisdiction to subject the management of the Fund to judicial control.

The Debtor relied strongly upon *Hobbs v. Occidental Life Insurance Co.*, 87 Fed. (2d) 380, where it was held that an order requiring the Insurance Commissioner of Kansas to surrender certain securities to a federal court receiver of an insolvent insurance company was not a proceeding against the State of Kansas in violation of the Eleventh Amendment. However, the facts in that case were quite different from those in the case at bar. There the securities were held for the benefit of policy holders of the insurance company, all of whom were parties to the receivership proceeding. With the approval of the Court, an arrangement was made with another insurance company whereby it assumed all the liabilities of the insolvent insurance company and took title to all of its assets. This arrangement was approved by all except 28 out of 27,000 policy holders, and the 28 dissenting policy holders were paid the amount of

their claims. Thereafter the turnover order against the Insurance Commissioner was entered, but, as the Court pointed out, the insolvent insurance company had no further liabilities after the other insurance company had assumed all of the liabilities and the policy holders had acquiesced therein. Thus it appeared that the purposes of the deposit had been fulfilled and that the Insurance Commissioner was not acting in conformity with his state law in retaining the same.

In the *Hobbs* case the court distinguished the *Lankford* case on the ground that in the *Lankford* case title to the fund was in the State, even though the real beneficiaries of the fund were private persons. Here too title to the securities is in the State of Maryland, although the beneficiaries of the trust are citizens of the State, and it would, therefore, appear that the *Lankford* rather than the *Hobbs* case is analagous to the case at bar.

The District Court, apparently conceding that the State, through its agent, was a party, held that "here the state is only a nominal and not a real party in interest", and that since the order of August 9, 1941, did not affect the States' "political or property rights" the Eleventh Amendment was not applicable. But every distinction which the District Court points out could apply with equal force to the situation in the *Lankford* case and yet this Court held in that case that the suit was barred by the Eleventh Amendment.

The District Court cited only two cases in addition to the *Hobbs* case: *Morrill v. American Reserve Bond Co.*, 151 Fed. 305, and *Porter v. Beha*, 12 Fed. (2d) 513. The *Morrill* case was a case at nisi prius decided in 1907, eight years before the decision of this Court in the *Lankford* case, and much of the language of the court in that

case has been overruled by the decision in the *Lankford* case. The facts in the *Porter* case are quite different from those in the case at bar, but it is not necessary to discuss these facts in detail because the court there clearly pointed out the distinction between that case and the *Lankford* case when it said: "Of course, a state may prefer to pursue a position of ownership of assets of insolvent or embarrassed corporations, * * * but New York has not assumed that position."

In the present case the securities held by the Insurance Commissioner of Maryland were not merely deposited with him as collateral security for the payment of a debt, but title to the securities was actually vested in the Insurance Commissioner of the State of Maryland, not in the particular person who might for the time being hold that office, but in that officer of the State of Maryland. Obviously this is the same thing as saying that title was vested in the State of Maryland. It is true that the State held title not for its own benefit, but as Trustee; but hold title it did, and the securities were not only physically delivered but they were at all times registered in the name of the Insurance Commissioner of Maryland as Trustee.

We respectfully submit that the situation is exactly the same as that presented to this Court in the *Lankford* case, and that the decision in that case is controlling here.

4. The Turnover Orders and the Injunction Order Were an Abuse of Discretion.

The rights of the secured contract holders cannot be cut down (*Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106; *Consolidated Rock Products Co. v. Du Bois*, 312 U. S. 510), and unless the state statutes are held to be wholly ineffective and to be completely disregarded

in determining the rights of the secured contract holders, no possible advantage can be gained by enjoining the various state officials from liquidating the trust property in their hands and making a distribution thereof to the beneficiaries of the trust. On the other hand, there is an ever present danger that delay will result in serious loss to the secured contract holders by depreciation in the value of the securities held in trust for them by the state officials in their respective states. Accordingly, even if it be assumed *arguendo* that the turnover orders and the injunction order were not void under the Eleventh Amendment and that the District Court had a discretionary power to enjoin disposition of the deposited securities pending the outcome of the reorganization proceeding, we nevertheless submit that the District Court abused its discretion in entering the turnover orders and the injunction order under the circumstances of the case.

As pointed out by Mr. Justice FRANKFURTER in *Railroad Commission v. Pullman Co.*, 312 U. S. 496, 500-501: "Few public interests have a higher claim upon the discretion of a federal chancellor than the avoidance of needless friction with state policies, whether the policy relates to the enforcement of the criminal law * * *; or the administration of a specialized scheme for liquidating embarrassed business enterprises * * *; or the final authority of a state court to interpret doubtful regulatory laws of the state * * *. These cases reflect a doctrine of abstention appropriate to our federal system whereby the federal courts, 'exercising a wise discretion,' restrain their authority because of 'scrupulous regard for the rightful independence of the state governments' and for the smooth working of the federal judiciary. * * * This use of equitable powers is a contribution of the courts in furthering the harmonious relation between

state and federal authority without the need of rigorous congressional restriction of those powers." See also *Palmer v. Massachusetts,* 308 U. S. 79, 89.

Had the District Court followed these precepts, it never would have entered an *ex parte* order requiring duly constituted officials in 15 states to turn over and surrender to a trust company in Charleston, West Virginia, over twenty million dollars of securities which had been deposited with such officials by Fidelity pursuant to the laws of their respective states. Such an order was clearly entered in complete disregard of the rights and duties of such state officials with respect to the deposited securities.

Not only have the federal courts restrained their authority because of "scrupulous regard for the rightful independence of the state governments", but the Congress also has wisely refrained from giving even the federal bankruptcy courts authority over certain kinds of business enterprises which are strictly regulated by the states and supervised by means of extensive administrative machinery set up under state statutes. It was for this reason that insurance companies, banks, and similar companies were excluded from the provisions of the Bankruptcy Act. For similar reasons, the Congress, although authorizing the bankruptcy courts to reject executory contracts, excepted "contracts in the public authority".[7]

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[7] Sections 116(1) and 216(4) of Chapter X of the Bankruptcy Act (U. S. C. Tit. 11, Secs. 516(1) and 616(4)). It might well be contended that the state statutes are in the nature of contracts between Fidelity and the respective states, since Fidelity could enter said states and transact business therein only in accordance with the terms and provisions of such statutes. Having transacted business pursuant to the statutes, Fidelity accepted the terms and provisions thereof, including the provisions with respect to deposits. These contracts are executory in the sense that the obligation of the Debtor to maintain the market value of the trust *res* still exists even though the Debtor has discontinued the sale of its contracts, and are also executory in that the trusts created by the contracts have not yet terminated and will not terminate until the payment of all obligations of the Debtor to contract holders in the respective states.

Even if it should be determined that Fidelity was not an insurance company, it was nevertheless in that class of corporations which are extensively regulated by the states. The federal courts, even if not prohibited from so doing by the Eleventh Amendment to the Constitution of the United States, should be extremely loath to issue turnover orders or injunction orders directed against state officials requiring them to turn over securities, or enjoining them from disposing of securities deposited with them pursuant to state law by such corporations.

These considerations have particular weight in situations such as that here presented where, if the state deposit laws are accorded that validity and effectiveness which neither the petitioners nor the Securities and Exchange Commission deny, the surrender of the state deposits to the Trustee for the Debtor would be an utterly futile act since the securities making up the deposits would be sold and the proceeds thereof turned over to the same contract holders who would have received the money had the deposits not been surrendered. The only thing accomplished would be a liquidation by the Trustee for the Debtor rather than by the duly constituted and experienced state authorities acting pursuant to their respective state statutes. If the contract holders in the respective states are ultimately to receive their distributive shares of the securities deposited in their states for their protection (which would clearly be the result unless the state deposit laws are to be entirely abrogated) why raise grave constitutional questions involving the respective spheres of the state and federal governments to accomplish a futile end? At the same time there would be no benefit to the contract holders but only loss and inconvenience caused by the unnecessary

delay and by requiring them to travel many hundreds of miles from their homes in order to vindicate their rights.

We, therefore, respectfully submit that even if the District Court did have a discretionary power to enter an injunction order, it should have stayed its hand in order to avoid a needless conflict with state policies, as exemplified by the various state deposit statutes affecting Fidelity.

Summary.

We earnestly urge that the fundamental issue presented by this case is whether the federal courts of bankruptcy have such jurisdiction and control over securities deposited by debtor corporations with state officials pursuant to valid state regulatory laws as to empower the bankruptcy courts to seize such state deposits and thereby, in effect, abrogate the state statutes. If not, then this proceeding is at an end because it is idle to talk of reorganizing the Debtor without having control of the state deposits. We submit that the state deposit laws are valid regulatory statutes which cannot be superseded by any supposedly "paramount" powers of the bankruptcy courts, that the Eleventh Amendment bars any attempt by the bankruptcy courts to require the state officials to surrender the state deposits, and that the state deposits are not property of the Debtor. We also respectfully submit that even aside from these considerations it was an abuse of discretion, under the circumstances of this case, for the District Court to enter the turnover orders and the injunction order, and that due regard for the delicate nature of the relationship between the federal courts and the states should have caused the District Court to stay its hand.

II.

THE PETITION OF THE DEBTOR SHOULD BE DISMISSED BECAUSE IT IS UNREASONABLE TO EXPECT THAT A PLAN OF REORGANIZATION CAN BE EFFECTED.

Section 141 of the Bankruptcy Act (U. S. C. Tit. 11, Sec. 541) provides that "Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied." Section 146(3) of the Bankruptcy Act (U. S. C. Tit. 11, Sec. 546(3)) provides: "Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if * * * (3) it is unreasonable to expect that a plan of reorganization can be effected." It is our contention that it is unreasonable to expect that a plan of reorganization of Fidelity can be effected and that, therefore, the petition of the Debtor should have been dismissed.

The Findings of the Courts Below.

The District Court in that portion of its opinion dealing with this issue (R. 194-197) apparently proceeded on the assumption that not only was the burden on the respondents to establish that it was unreasonable to expect that a plan of reorganization of the Debtor could be effected, but that it was incumbent upon the respondents to show that it would be *impossible* to reorganize Fidelity. Under the law, however, the burden is upon the Debtor to sustain this issue and it is incumbent upon the Debtor to prove that it is not unreasonable to expect that a plan of reorganization can be effected. *Marine Harbor Properties, Inc., v. Manufacturers' Trust Co.*, No. 24, this Term, decided November 9, 1942.

On the evidence before it the District Court found that the prospects for the rehabilitation and continued operation of the Debtor were to say the least far from promising. The court said: "The proceedings are not yet at a stage where the court is called upon to consider any particular plan of reorganization. It is true that the broad picture developed by the testimony at the hearing does not present a very favorable view with respect to the rehabilitation and continued operation of the Debtor as a face amount certificate company. Whether the Fidelity plan is fundamentally unsound depends upon the definition given to that term. It is apparent that it is a plan of investment which yields a very low rate of income to the investor and subjects the investor to substantial loss should he cease to pay the required installments during the early stages of the contract; but this very element of weakness from the investor's standpoint strengthens the company from an operating viewpoint, provided the contracts can be sold in sufficient volume to take care of the necessary overhead expenses. It is extremely doubtful whether, in view of unsettled economic conditions and the critical international situation, the Fidelity plan would any longer appeal to a large public; but it is not impossible; and it is not the duty of the court to decide for the public that investors will not or should not buy these contracts in the future." (R. 194-195).*

Viewing the situation in an entirely different light, the Circuit Court of Appeals, after stating the conclu-

* This last conclusion of the District Judge is at variance with the general rule stated in Finletter, The Law of Bankruptcy Reorganization, pp. 62 and 63, as follows: "The nature of the business of the debtor is important in determining feasibility. A public utility or large industrial company with a prosperous history carries with it almost a presumption of the necessity for its continuance as a going concern. On the other hand the courts will inquire carefully into the feasibility of a reorganization of an enterprise of no public importance which has not proven that there is a demand by the public for its product."

sions of the District Court, said: "This resumé of the District Judge presents a dark picture of the company's future. Nevertheless, it suggests that some plan of reorganization not yet formulated, much less proposed by any person financially able to carry it into effect, may not be impossible. We think it is our duty to review the situation realistically, and when this is done, there appears to be no reasonable hope of a reorganization of the business as a going concern, but only the immediate need of a liquidation of the company's assets for the benefit of the contract holders. Obviously there will be nothing left for the stockholders. * * * Moreover, as the District Judge points out, it is quite doubtful whether this form of investment presents any further appeal to a public that has now been informed as to the nature of the business; certainly the possibility that thousands of contract holders could be persuaded to modify their contracts and scale down their claims to enable the company to go on is so remote as to exist only in the imagination. No proposal for the investment of new capital has been forthcoming." (R. 259-260).

Contentions of the Petitioners.

As a matter of fact the Securities and Exchange Commission in the argument before the Circuit Court of Appeals admitted that there was virtually no hope whatsoever for the rehabilitation and reorganization of Fidelity as a face amount certificate company or as any other kind of going concern; they frankly stated that liquidation was practically inevitable. And even in this Court the Securities and Exchange Commission does not seriously argue that Fidelity can be reorganized as a going concern; they, in fact, admit that the possibility of its rehabilitation as a going concern is "negligible". (S. E. C. brief, p. 46). On the other hand, the Debtor and the

Trustee, still holding fast to the illusion that somehow, in some way, Fidelity can be reorganized, refuse to give up hope and argue that there is "much testimony of qualified witnesses that in the opinion of such witnesses Fidelity can be reorganized". In support of this argument they refer to the testimony of seven witnesses. In order to show clearly the essential weakness of the testimony thus relied upon, we have printed as Appendix B to our brief, excerpts from the testimony of these witnesses which show its vague nature and the wholly insufficient reasons given by each of the witnesses for his opinion. In a large measure this testimony speaks for itself and needs but little comment.

The witness D. A. Burt, a stockholder of Fidelity, did testify that in his opinion Fidelity could be reorganized but his testimony clearly shows that he was expressing a fond hope rather than an intelligent opinion (App. B, p. 80). He admitted that a number of problems existed in connection with any possible reorganization and that he had not made any study of the matter; and he refused point-blank to indicate any opinion as to what form a reorganization should take. He recognized that new capital would be required but offered no suggestions as to how it could be raised. He also thought the present stockholders ought to have some equities in the new company. He talked a great deal about the supposed advantages of the Fidelity plan and pointed out that he and other members of his family had purchased contracts, but when asked whether he or any of the members of his family still owned such contracts at the time of the institution of this proceeding he said he didn't know.

The witness Hubert F. Young, an employee interested in keeping his job, also testified that in his opinion

Fidelity should be reorganized and offered three suggestions: (1) that a mutual insurance company be formed, (2) that a new company with new capital take over the liabilities under the contracts on the basis of the liquidating value of the various funds, and (3) that Fidelity merge with another insurance company. However, he admitted that he did not see much possibility of a merger and offered no suggestions as to how the new capital could be raised although he admitted that under the Investment Act of 1940 a capital of $50,000 was required of old companies, and $200,000 of new companies. He finally indicated that he had in mind some vague idea of creating a capital structure by reducing the liabilities to the contract holders to 70% or 80% of the full amount. When pressed about the hazard to contract holders in investing funds of the company in semi-speculative and speculative securities, he replied: "Well, if they didn't they would probably lose their money some other way in my opinion." (App. B, p. 87).

Auditor Sims testified that when he had filed the bill of complaint for the appointment of receivers in the Circuit Court of Kanawha County he had "hoped" that the company could be reorganized and had a "thin and nebulous" idea that in some way the "company could be mutualized and turned over to the contract holders". On the other hand, he expressed the very emphatic opinion that Fidelity could not be reorganized as an annuity company, and pointed out that "twenty-six of the biggest insurance companies in the last five years have lost $66,000,000 on annuity contracts". (App. B, p. 88).

The witness H. Isaiah Smith indicated clearly that he was not qualified as an expert to express an opinion and that his personal opinion that Fidelity should be reorganized was based solely upon the fact that "with

the assets the size that Fidelity has, a reorganization of some sort can be done". He further indicated that he had no idea what kind of a plan could be worked out and that he did not know whether any plan could be worked out which would be approved by two-thirds of the creditors or contract holders. He had only the vaguest idea of what might be accomplished and frankly admitted that he had not tried to work out even an outline of a plan of reorganization (R. 483).

The witness Allen G. Messick, in a broad general way, indicated that in some way not explained by him Fidelity could be reorganized. This was the same man who had been brought into the company for the specific purpose of putting it on its feet and raising new capital and who had for two years tried, without success, to reorganize it. At one time, in company with another individual, he entered into a contract with Fidelity to furnish additional capital of $500,000 but, for reasons of his own, failed to carry out the contract. Certainly the testimony of such a witness is entitled to no consideration.

The witness Raymond Latta, an actuary, had been employed in 1940 by Fidelity for the specific purpose of assisting in working out some plan of reorganization. He had made tentative studies as to several proposed plans of reorganization, none of which were carried to fruition and all of which contemplated a reduction in the claims of the contract holders. He did not testify that in his opinion Fidelity could or should be reorganized. As a matter of fact the District Court refused to permit him to express his opinion on this question and insisted that he was qualified only to express an opinion as to whether or not it was actuarily possible to formulate a plan of reorganization (R. 1105-1106). As to this the answer of the witness was in the affirmative because, as he pointed

out (App. B, pp. 91-92), almost anything is actuarily possible. The record shows that if he had been permitted to express his opinion, he would have testified that it was unreasonable to expect that a plan of reorganization could be effected and that the Debtor can never be reorganized either as a face amount certificate company or as a life insurance company.

The witness Howard E. Reed, another employee, whose duties had been to make speeches promoting the Fidelity plan, expressed the opinion that Fidelity could be reorganized but he indicated that the only basis for his opinion was "purely from the sales standpoint". He thought there was a great field for the Fidelity contract (R. 737). His opinion was influenced by the fact that he thought the Franklin Life Insurance Company was doing well in the sale of annuity contracts (R. 735-736); and yet the Vice-President of the same Franklin Life Insurance Company later testifying on behalf of the respondents stated that that company had undertaken to sell a contract very similar to the Fidelity contract, had instituted an aggressive sales campaign similar to that conducted by Fidelity, had employed a number of the salesmen who had been with Fidelity, but had found results very disappointing (R. 1016-1018). He further pointed out that the Franklin sales volume on this contract reached a peak of $300,000 in April, 1941, but by June, 1941, with the Defense Bond program competing very seriously, it had dropped to $100,000 and had been below that ever since (R. 1018).

Mr. John E. Marshall, Sr., large stockholder, general counsel and prime mover in Fidelity's affairs for a number of years, testified "I have not any idea of the plan, have not worked on the plan, and don't feel that I am competent to work on it. I have hoped some plan could

be worked out * * * I would not even sit here as a witness and say a plan could be promulgated * * *" (R. 420).

The witness Henry M. Steussy who had had long experience in selling Fidelity contracts, testified that in his opinion Fidelity could not be reorganized (R. 1027-1028, 1039-1040).

The witness Tom Foulk, General Attorney for Fidelity, testified that in his opinion Fidelity could not be reorganized. He said: "I felt that so far as an investment company was concerned that we were done. I couldn't see any possibility to carry on in the investment field. We couldn't qualify and go ahead under the Investment Act of 1940, and I felt that that type of business had had its day * * *" (R. 944-946).

Even at this late date, after having had complete charge of the Debtor's affairs for twenty months, and with full opportunity to make such investigations as might be necessary, neither the Trustee nor the Debtor are able to present even an outline of a proposed plan of reorganization, nor are they able to suggest in any tangible way what kind of a plan of reorganization might possibly be effected. The most they are able to do is to suggest three possibilities: (1) that some insurance or investment company might be found to take over or buy the assets of Fidelity and issue to Fidelity contract holders investment certificates or insurance policies which might be worth more than the contract holders would get through liquidation, (2) that a beneficial merger might be worked out with some other investment company or insurance company, and (3) that the organization of some kind of a mutual company is not beyond the realm of consideration. (Debtor-Trustee's brief, pp.

47-48). It is argued that these are "suggestions" supported by the record, and "thoughts" which should not be relegated to the realm of mere possibilities as distinguished from probabilities until there has been some opportunity to transform them into realities (Debtor-Trustee's brief, p. 48). However, not only does the record not support these "suggestions" and "thoughts", it clearly refutes them.

The Debtor's own witness Hubert F. Young, made it clear that there was no basis for hope that some other insurance or investment company would buy Fidelity's assets or be interested in a merger with Fidelity, because, as he pointed out, Fidelity had no advantage to offer to any other company (R., 631). The same opinion was expressed by the witness Steussy who said Fidelity "has lost that which a company taking it over is after—the sales organization. It has disappeared, disassembled and disintegrated" (R. 1027-1028). And is it not reasonable to suppose that if there were any possibility of a merger with another investment company or insurance company, that some such company would certainly have long since communicated with the Trustee and suggested such a merger?

The Debtor and the Trustee infer that an insurance company could issue to each of the contract holders of Fidelity, insurance policies which would be worth more than the contract holders would receive in liquidation and they conclude that such an arrangement would afford the contract holders the benefit, in whole or in part, of the cost of selling the insurance. Not only is there no evidence whatsoever to support this conclusion, but a moment's reflection will indicate clearly that it is false. In the first place, no insurance company could issue policies to all the contract holders without regard to their

insurability, and in the second place, no insurance company could issue to a contract holder an insurance policy in any amount greater than his equity would buy on the basis of the ordinary insurance rates applicable to him. In other words, the contract holder would get no more than if he took his dividend in liquidation and made his own independent purchase of insurance.

The suggestion is also made that at least "the solvent funds or series of Fidelity contracts might be reorganized" and the statement is made that the Series A, B, C, and D funds are solvent (Debtor-Trustee's brief, pp. 46, 48). But, as pointed out by the Securities and Exchange Commission (S. E. C. brief, p. 8) the solvency of the funds depends upon the extent to which their inter-fund accounts receivable are collectible assets, so it cannot be stated that there is any one fund which is definitely solvent. In addition, the Debtor's suggestion is based upon the assumption that the state deposits will be entirely disregarded because otherwise it is not possible to talk about reorganizing one or more of the Fidelity funds or series The state deposits cut across all series funds and the series fund theories advanced by the Debtor and the Trustee are untenable unless the rights of the contract holders with respect to the state deposits can be eliminated from consideration.

We respectfully submit that not only has the Debtor failed utterly in meeting the burden of proving that it is not unreasonable to expect that a plan of reorganization can be effected, but all of the evidence demonstrates beyond peradventure of a doubt that it is unreasonable to expect that a plan of reorganization can be effected.

Liquidation as a Method of Reorganization.

Actually, neither the Debtor nor the Trustee nor the Securities and Exchange Commission have any real hope that Fidelity can be reorganized either as a face amount certificate company or as an insurance company. Their main reliance is upon the contention that "a slow, orderly and unified" liquidation is a method of reorganization within the meaning of Chapter X of the Bankruptcy Act. The Circuit Court of Appeals did not pass upon this question because it concluded that if liquidation were inevitable, the interests of the contract holders would be best subserved in the state court proceedings. The District Court, however, did conclude that "it is not necessary that there be a reasonable prospect for the successful rehabilitation of the Debtor as a going or continuing corporation. It is sufficient if it is shown that the Debtor is in a position to conform to and obtain the benefits of the statute for a slow, beneficial and orderly liquidation." (R. 196).

There are two clear answers to this contention: (1) that a "slow, beneficial and orderly liquidation" is not a plan of reorganization within the meaning of Chapter X, and (2) that even if a plan providing for the creation of some sort of liquidating corporation to conduct a slow and orderly liquidation of the Debtor's assets could be considered a plan of reorganization within the meaning of Chapter X, nevertheless there has been no showing in this case that any such plan is necessary or would be beneficial to the contract holders, or that it is reasonable to expect that any such plan could be effected.

We will not in this brief attempt to argue fully the first point because we understand that it will be fully discussed in the Wisconsin-Iowa brief. We do wish to

point out, however, that liquidation is the antithesis of reorganization and it would indeed seem anomalous to use a statute expressly adopted for the purpose of providing the machinery for reorganization of corporations as a vehicle to accomplish the liquidation of a corporation, particularly when the Bankruptcy Act itself provides other machinery for the liquidation of insolvent corporations. In addition, Section 236 of Chapter X (U. S. C. Tit. 11, Sec. 636) specifically provides that if no plan of reorganization is consummated, the judge may either direct that bankruptcy be proceeded with, or dismiss the proceeding under Chapter X. If liquidation can be accomplished under the guise of a plan of reorganization under Chapter X why authorize the court to direct that bankruptcy be proceeded with or to dismiss the petition for reorganization if no plan is consummated? It should also be observed that Section 146(3) of Chapter X would be virtually nullified if a slow and orderly liquidation could be deemed a plan of reorganization because there could always be a plan providing for liquidation and it would, therefore, never be unreasonable to expect that such a plan could be effected.

The petitioners argue that Section 216(10) of Chapter X (U. S. C. Tit. 11, Sec. 616(10)) provides that a plan of reorganization may include the sale of all or any part of the debtor's property and the distribution of all or any of its assets, or the proceeds derived from the sale thereof among those having an interest therein. But we submit this is not the effect of Section 216(10). Section 216 sets out a number of things which *must* be included and some things which *may* be included in any plan of reorganization, and paragraph 10 of this section requires that a plan "shall provide adequate means for the execution of the plan, which may include", among

other things, the sale of all or any part of the debtor's assets. This is not at all the same as saying that a plan providing for the sale of all of the assets and the distribution of the proceeds thereof is a plan of reorganization. Paragraph 10 merely gives broad power for the consummation of a real plan of reorganization and the portions thereof relied upon by the petitioners should be read in connection with paragraph 7, which requires that a plan shall provide for any non-accepting creditors "adequate protection for the realization by them of the value of their claims against the property dealt with by the plan" either by the transfer or sale or retention by the debtor of the property subject to the claims, or by a sale of such property free of claims, at not less than a fair upset price. In other words, the portions of paragraph 10 relied upon by the petitioners are merely included to carry into effect those provisions which must, under paragraph 7, be included in a plan in order to fully protect non-assenting lien creditors.

Aside from these considerations, the contention of the petitioners that it is not unreasonable to expect that a plan of reorganization can be effected because there is a necessity for a slow and orderly liquidation which can be accomplished only through the means of a proceeding under Chapter X, is without foundation. There is no special problem in disposing of the assets of the Debtor in spite of what might be said as to the rating of the securities deposited with the various states. The deposited securities constitute 95% of the assets of the Debtor and with the possible exception of some few securities deposited with the Insurance Commissioner of West Virginia, all of them are readily marketable. Of the remaining 5% of the assets, one-half is represented by cash and the other one-half by tangible assets. Only

about $350,000 or $400,000 of assets, or approximately 2% of the total assets, is represented by real estate. Certainly this is no indication that a *slow* liquidation is required. Certainly there is no necessity of continuing this proceeding under Chapter X merely in order to work out a plan to liquidate assets, practically all of which are readily marketable securities.

We, therefore, respectfully submit that even if it were admitted, for the purposes of argument, that under some circumstances a slow and orderly liquidation might be deemed a plan of reorganization, certainly this is not such a case, and there has been no showing whatsoever that there is any necessity for a slow and orderly liquidation by means of some new corporation to be created for that purpose, and no showing whatsoever that any such course of action would be in the slightest degree beneficial to the creditors of Fidelity.

III.

THE PETITION OF THE DEBTOR SHOULD BE DISMISSED BECAUSE IT APPEARS THAT THE INTERESTS OF THE CREDITORS WOULD BE BEST SUBSERVED IN THE PRIOR PENDING STATE COURT PROCEEDINGS.

Section 146(4) of Chapter X of the Bankruptcy Act (U. S. C. Tit. 11, Sec. 546(4)) provides: "Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if * * * (4) a prior proceeding is pending in any court and it appears that the interests of the creditors and stockholders would be best subserved in such prior proceeding."

It is conceded by all parties that the stockholders have no further interest in Fidelity, and it is likewise conceded that the West Virginia state court proceeding and other state court proceedings were prior pending.

proceedings. Accordingly, if it appears that the interests of creditors would be best subserved in such prior pending state court proceedings, then the Debtor's petition was not filed in good faith, and it should have been dismissed.

Contentions of the Petitioners.

Most of the petitioners' argument on this point is directed to a showing that the proceedings in the several state courts are not under any reorganization statute, and that there is no single prior pending state court proceeding, that is, that there is no one state court having jurisdiction over all of the assets of Fidelity. It is said that the prior pending state court proceedings are mere equity receiverships and that all of these proceedings lack the safeguards provided by Chapter X of the Bankruptcy Act. A number of "safeguards" which it is argued are of benefit to the contract holders of the Debtor, are referred to (Petitioners' brief, pp. 53-54), but it will be noted that with possibly two exceptions all of them pertain to the preparation, submission and approval of a plan of reorganization and would, therefore, be pertinent only if there were some hope of reorganization. The only safeguards which could possibly be said to have any bearing apart from a plan of reorganization, are the report to creditors as to the value of their respective interests, and "the independent appraisal of the assets of the Debtor's estate by the Securities and Exchange Commission". As to the first, it is sufficient to say that a report to creditors showing the extent of their interests is not peculiar to Chapter X, and we think we can safely say that all creditors will be advised of their interests in the Debtor's assets and the value thereof, in the pending state court proceedings. With respect to the suggested independent appraisal by the Securities and Exchange Commission of the Debtor's

assets, we can say merely that not only do we find no provision in Chapter X for such an appraisal or valuation by the Securities and Exchange Commission, but the Securities and Exchange Commission has not indicated in this proceeding that it has the facilities for making such an appraisal or that it will undertake to do so. As a matter of fact, practically all of the assets consist of securities, which do not present any difficult problems of valuation. The remaining assets are largely real estate, which constitute possibly 2% of the Debtor's assets.

It is true that none of the prior pending state court proceedings were instituted under the provisions of any state reorganization statute. We would also be willing to concede, for the purposes of argument, that if it were reasonable to expect that a plan of reorganization (as distinguished from a plan of liquidation) could be effected, the "safeguards" provided by Chapter X and relied upon by the petitioners might well be considered in determining whether the interests of creditors would be better subserved in the proceeding under Chapter X or in the prior pending state court proceedings. *Marine Harbor Properties, Inc. v. Manufacturers' Trust Co.*, No. 24, this Term, decided November 9, 1942. But here, where there is no real hope of a reorganization, and when it is practically conceded that liquidation is not only inevitable but is for the best interests of the contract holders, these safeguards have no real bearing. They are important only if there is a reasonable prospect that a plan of reorganization can be effected. If there is to be a liquidation, then there will be no plan of reorganization to be reported on by the Securities and Exchange Commission or approved by the court.

The Circuit Court of Appeals held, largely on the basis of the findings of fact of the District Court, that it was

clearly not feasible to rehabilitate the Debtor as a going concern. The court referred to the fact that this was virtually conceded by the District Court and by the Debtor, the Trustee, and the Securities and Exchange Commission, and it pointed out that the only suggestion made by these parties was that it was feasible to have a "slow and orderly liquidation" in the federal court and that such a "slow and orderly liquidation" was a method of reorganization within the meaning of Chapter X (R. 260). The Circuit Court of Appeals clearly did not pass on the question of whether a "slow and orderly liquidation" was a method of reorganization, but instead held (1) that the record did not justify the conclusion that it was reasonable or feasible or desirable to have a "slow and orderly liquidation" in the federal court, and (2) that since liquidation was inevitable, the question then arose as to whether the interests of the creditors would be best subserved by such a liquidation in the federal court, or by liquidation in the state courts (R. 261-263).[9]

The issue then is not whether Fidelity can best be *reorganized* in a proceeding under Chapter X or whether the state court proceedings will better serve that purpose since liquidation in some form is inevitable, the issue is simply whether the interests of the creditors can best be subserved by a liquidation in the federal court or by a liquidation in the prior pending state court proceedings.[16] We strongly urge that not only is there a com-

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[9] The Securities and Exchange Commission apparently concurs in this construction of the opinion of the Circuit Court of Appeals. Brief, pp. 28-29.

[16] Of course, as we have pointed out in the argument under Section 146(3), the whole idea of liquidation is completely antagonistic to any concept of reorganization. This being the case there never would be any issue of whether the interests of creditors would be best subserved by a liquidation in the federal court in a Chapter X proceeding. If liquidation appears inevitable, the proceeding should be dismissed under Section 146(3). We, therefore, discuss the point on the same basis the Circuit Court of Appeals did, that is, by assuming *arguendo* without conceding, that liquidation may be a form of reorganization.

plete failure on the part of the Debtor to show that it was reasonable or feasible or desirable to have a "slow and orderly liquidation" in the federal court (*supra*, pp. 55-56), but the record shows clearly that the interests of the contract holders would be best subserved by a liquidation in the pending proceedings in the courts of their respective states.

The Contentions of the Securities and Exchange Commission.

The Securities and Exchange Commission argues that a liquidation in the federal court rather than in the state courts, is desirable because there are so many state court proceedings, and there is a necessity for a central administration of the Debtor's assets. Three reasons are urged in support of this contention: (1) "the necessity for impartial investigation" of the acts of management of the Debtor, (2) "the necessity for a single administration to settle problems of marshalling assets and of distribution", and (3) "the necessity of orderly procedure to liquidate the assets". Keeping in mind that we are here considering the desirability of a central administration of a *liquidation* in the federal court, as compared with *liquidation* in the state courts, we will discuss each of these points.

1. "*The necessity for impartial investigation.*" It is stated that "there are strong indications in the record that extravagance and other serious mismanagement mark Fidelity's history", and it is said that an investigation of possible civil actions on behalf of Fidelity's estate against the officers, directors, and perhaps others, is desirable. Assuming the truth of these statements, we submit that such an investigation is clearly secondary to the principal objective, namely, the liquidation of the state deposits for the benefit of contract holders as expeditiously as possible. There would seem to be no

reason whatsoever why the liquidation and distribution of the bulk of the assets to contract holders should be delayed pending an investigation of whether there exist possible civil actions against former officers and directors of the Debtor. Certainly nothing would prevent a liquidation and distribution of the bulk of the assets to contract holders now, and an investigation now or later as to whether they have any such civil rights of action.

It is suggested, however, that problems of venue and jurisdiction would present obstacles to civil suits at the instance of state officials in every state but West Virginia, and that the "interlocking relationships among the officials of Fidelity and the receivers and their counsel" are such as to indicate that there would be no adequate investigation and prosecution of causes of action against Fidelity's management by the officers appointed by the West Virginia state court. Without conceding that it would not be possible for investigations to be made and suits to be instituted at the instance of other state courts, we respectfully submit that there is no justification whatsoever for the inference that the Circuit Court of Kanawha County, West Virginia, would be remiss in its duty and would not appoint impartial disinterested persons to conduct such investigation as might be necessary and to prosecute such suits as might be proper.

The Securities and Exchange Commission and the petitioners treat the matter as though the question were whether such investigations could best be conducted by the Central Trust Company, or by Mr. H. Isaiah Smith and Mr. Ross B. Thomas, the West Virginia state court receivers. But we submit that this is not at all the issue. The question is not whether the interests of the creditors will be better protected by the Central Trust Company than by the present West Virginia state court receivers;

the question to be decided is whether the interests of the creditors will be better protected by the federal court or by the Circuit Court of Kanawha County, West Virginia. In initially appointing receivers, Judge Bouchelle of the Circuit Court of Kanawha County, was careful to appoint as one of the receivers a man who had broad previous experience, who had held responsible public positions with honor, who was respected for his honesty and integrity, and who had had no previous connection whatsoever with Fidelity. That Mr. H. Isaiah Smith is such a man is demonstrated by the fact that immediately upon the appointment of Central Trust Company as Trustee herein Mr. Smith, with the approval of the District Court, was employed to aid and assist it in performing its duties as Trustee. He has continued in the employ of the Trustee and, with the possible exception of investment problems, has supervised virtually all of the Debtor's affairs for the Trustee.

No one suggests that Mr. Smith would not be capable of making the impartial investigation which is deemed desirable, but it is contended that his co-receiver, Mr. Ross Thomas, is not in a position to do so because of his previous relationships with Fidelity. But this contention completely ignores the fact that in appointing Mr. Thomas as co-receiver, Judge Bouchelle did so solely because of his familiarity with Fidelity's affairs and his previous broad experience in corporate reorganization matters. Judge Bouchelle had been told that an effort would be made to work out some sort of voluntary partial reorganization of Fidelity, and he appointed Mr. Thomas to aid in this aspect of the receivership, at the same time stating that if it later appeared that no such voluntary plan of reorganization could be worked out, Mr. Thomas would be discharged as receiver. This in-

formation was communicated to the District Court by a letter from Judge Bouchelle and there is no reason to suppose that he will not carry out his announced purpose.

The argument of the Securities and Exchange Commission and the petitioners comes simply to this. Because Mr. Ross B. Thomas was appointed one of the receivers for Fidelity by the West Virginia state court, it is now necessary that all the contract holders throughout the country be required to present their claims to the federal court at Charleston, West Virginia, many miles from their homes, and that the proceedings pending in the courts of their own states, which are conveniently located and readily accessible to them, and which would provide a prompt distribution of the assets deposited with their state officials for their protection, shall now be abandoned. We respectfully submit that such a course of action could hardly be said to be in the best interests of the creditors.

2. *"The necessity for a single administration to settle problems of marshalling assets and of distribution."* It is suggested that there is a "complex task of disentangling the assets of each of the several series in order that they may be properly and effectively marshalled." It is assumed that the reserve funds of each series and the securities in which they were invested were effectively segregated as separate trusts and that the contract holders must be divided into classes by series and their claims limited to the assets which may ultimately be determined to belong to their particular series. At the same time it is recognized that there was no real segregation and it is urged that before distribution can be made "the accounts of the various funds *inter sese* must be settled". Such a theory of course ignores the fact

that pursuant to valid state laws, 95% of the assets of Fidelity have been deposited with various states as security for the contract holders of Fidelity, and if the validity of the state deposits is recognized, the series fund theory of distribution must necessarily fall. (*supra*, p. 52). Also, this theory ignores the fact that there is no contract provision for a segregation of reserve funds except possibly with respect to Series B, C and D. (*supra*, p. 14). Series C has only one contract holder (R. 492) and Series D is also comparatively small and was sold only in four states (R. 315).

It is further suggested "that there is a problem whether states may retain securities accepted in disregard of knowledge or notice that the assets deposited belong to particular series funds and were deposited to secure liabilities of other series", and that "should this issue be decided adversely to the states in question, these states might not be able to retain their entire deposits". Here again several erroneous assumptions are made: (1) that states did accept securities for deposit with knowledge or notice that such securities belonged to particular series funds, and (2) that if so, such securities were improperly deposited and, therefore, cannot now be retained.

We have already shown (*supra*, pp. 9-11) that it is not true that the reserve funds and the securities purchased therefrom were actually segregated by Fidelity. On the contrary, the record shows clearly that although separate books were maintained for the B, C and D series, no actual segregation of securities purchased from the reserve funds of these series was ever even attempted until very recent years, and that even when some little attempt was made to segregate the securities, it was found to be utterly impossible. The record also clearly

shows that even if the state laws had permitted separate series deposits and if initially these deposits had been segregated by series, it would have been impossible for Fidelity to function and to have kept separate deposits for each series (R. 586, 608-609, 652).

Likewise, there is no foundation for the statement that the state officials accepted deposits of securities with knowledge that the securities belonged to one particular series fund. We have shown above (*supra*, pp. 9-10) that none of the securities were earmarked or in any way identified with a particular fund when they were originally deposited. The securities were deposited with the state officials as one general deposit and there was no effort made to advise the state officials that the securities belonged to one series fund or another (R. 586-587).

But even if there had been notice to the state officials at the time securities were deposited that they had been purchased from particular reserve funds, this would not mean that such deposits would now have to be surrendered. None of the state laws provide for a segregation of deposits by series funds. All deposits were in fact general deposits and all of the state laws seem to contemplate only general deposits for the benefit of *all* contract holders in the state. The idea is advanced that the so-called "improper" deposits can be recaptured on some theory of tracing trust funds, but it must be remembered that the state laws must be read into the contracts as a part thereof and provisions of the contract which are inconsistent therewith must fall. If the state laws do not provide for deposits segregated by series, and for separate trusts, then any provisions in the contracts purporting to create such separate series trust funds cannot be given effect so as to defeat the purpose or requirements of the state deposit laws.

As a matter of fact, all of the contracts specifically provide that the reserve funds shall be invested in securities which shall be deposited in trust as required by the laws of the State of West Virginia. The laws of the State of West Virginia provide for the deposit of the securities in one trust for the benefit of all contract holders except to the extent that securities have been deposited in other states for the protection of contract holders in such states. The contract, therefore, specifically provides not for deposits in trusts segregated as to separate series funds, but deposits in trust pursuant to state deposit laws. The only separate trusts provided for are the trusts for the contract holders in the states which require such deposits in trust.

It is also urged that there may be some conflicts of interest between resident and non-resident contract holders in respect to the deposits in each state and that, therefore, in order to avoid giving the resident contract holders an advantage, both the resident and the non-resident contract holders should be compelled to litigate their rights in the federal court at Charleston, West Virginia. This is certainly a novel proposition. What possible justification is there to require Maryland contract holders to go to the expense and inconvenience of litigating in West Virginia their rights in the Maryland deposit merely because it is possible that residents of Pennsylvania, for instance, may assert some sort of claim adverse to that of the Maryland residents? We completely fail to see the equities of any such procedure. The Maryland contract holders of the Debtor bought their contracts in reliance upon the Maryland law and in the belief that the Debtor deposited in Maryland securities of a sufficient value to protect them (R. 536-537, 921, 936-937, 1048). Contract holders in states not requiring de-

posits bought their contracts in reliance upon West Virginia law and the deposit with the Treasurer of West Virginia. What possible equitable principle would compel the Maryland contract holders to give up their securities and litigate their right thereto in a court four hundred miles from their residence merely because the other contract holders who relied on the West Virginia law and the West Virginia deposit must assert their claims in West Virginia?

3. *"The necessity of orderly procedure to liquidate the assets."* The argument that one centralized administration is necessary and essential for the orderly liquidation of the Debtor's assets is based upon the false premise that each state depositary will separately proceed to liquidate immediately "without regard to the overall effect of simultaneous sale", and also fails to take into account that regardless of the rating of the securities held by Fidelity, all of the securities deposited with all of the states, with the possible exception of West Virginia, are readily marketable, that the only securities which might not be readily marketable are deposited with the Treasurer of West Virginia and that the only other assets, such as real estate, which might not be quickly marketable are located in the State of West Virginia.

Assuming that the sale and liquidation of the deposited securities requires careful handling and special supervision, what reason is there to suppose that each state official will proceed to liquidate immediately without regard to the overall effect of simultaneous sale. As said by the Circuit Court of Appeals: "The liquidation in every state in which deposits were made will be subject to the supervision of established governmental departments, as well qualified for the business as the trustee

in bankruptcy. There is every reason to believe that the liquidation under their supervision will proceed without needless expense in a careful and expeditious manner so as to save as much as possible for the contract holders" (R. 262).[11] It may be assumed that the state courts supervising the sale of the deposited securities by the state officials and the state receivers will require the liquidation and sale of such securities in an orderly manner so as to realize as much as possible therefor without at the same time running the risk of losing large sums of money by reason of fluctuations in security markets.

Since all of the assets which might be considered not to be readily marketable are concentrated in the West Virginia assets and all of them would come under the control of the Circuit Court for Kanawha County, West Virginia, or the Insurance Commissioner of West Virginia in the event this proceeding were dismissed, there would be only one central administration of, or supervision over the sale of such assets, the only difference being that the administration would be in the West Virginia state court instead of in the West Virginia federal court.

The State Laws Should Be Construed by the State Courts.

The argument that a centralized administration of all of the securities deposited with the various state officials is necessary in order to determine judicially the numerous questions alleged to exist with respect to the rights of the various contract holders, is likewise based on a

[11] Shortly after the decision of the Circuit Court of Appeals directing the dismissal of the Debtor's petition, representatives of all 15 states holding deposited securities met in a conference at Charleston, West Virginia, to discuss plans for the liquidation of the state deposits. It was agreed at this meeting that the respective states would not undertake to sell their securities without first advising and consulting with the other states, and that the various state officials having charge of the sale of the securities constituting the state deposits would cooperate in order to bring about the most advantageous sales and to avoid depressing the market for the securities.

false premise. It is argued that if these various questions are determined by the state courts, fourteen or fifteen separate judicial determinations will be required, and the assumption is made that if there is centralized administration there will be only one judicial determination of one legal question. But of course this is not true. Centralized administration as contended for by the appellees would mean that there would be but one forum for the determination of these numerous legal questions alleged to exist, but there would still have to be a separate judicial determination as to the rights of the contract holders in each of the different states where deposits were maintained by the Debtor. In other words, in the one case there would be fourteen or fifteen legal questions judicially determined by as many courts; in the other case there would be the same number of legal questions to be judicially determined, but the determinations would be made by one court.

No advantage can possibly accrue by having these various questions determined in one forum. The determination of these questions depends upon a construction of the various state statutes, a construction of the contracts of the Debtor, and a consideration of the actions of the Debtor and its contract holders with respect to state deposits. But there is no federal law governing such matters. *Erie Railroad v. Thompkins*, 304 U. S. 64. On the contrary, all of such matters are governed by state law, and consequently the rights of the contract holders in one state will differ from the rights of the contract holders in other states to the same extent as the laws of those states differ. If this be an inconsistency, it is one which cannot be avoided, and would exist regardless of whether the ultimate decision was made in the federal court or in the various state courts.

Since this is the situation, it seems to us that it would be more desirable to have the Court of Appeals of Maryland, for instance, decide what the Maryland law is with respect to contracts of the Debtor sold in this State, and what the rights of the Maryland contract holders of the Debtor are with respect to the securities held in trust for them by this appellant, rather than have the Federal Court at Charleston undertake to determine how the Court of Appeals of Maryland would construe and apply the Maryland law.

The desirability of following this procedure and the extreme reluctance of the federal courts to construe state statutes or determine matters of state law, particularly in the absence of applicable state decisions, has recently been forcefully emphasized by this Court. In *Thompson v. Magnolia Co.*, 309 U. S. 478, this court held that although "a court of bankruptcy has an exclusive and non-delegable control over the administration of an estate in its possession", nevertheless "the proper exercise of that control may, where the interests of the estate and the parties will best be served, lead the bankruptcy court to consent to submission to state courts of particular controversies involving unsettled questions of state property law and arising in the course of bankruptcy administration." (p. 483). Acting on this principle this Court directed the District Court to require the trustee in bankruptcy to submit to the Illinois state courts the question of the fee simple ownership of a right-of-way.

In *Railroad Commission v. Pullman Co.*, 312 U. S. 496, this Court reversed the decision of a three-judge court construing a Texas statute, and held that the question of state law should not be determined by the federal court but should be submitted to the state court for decision. This Court said: "The lower court did deny that the Texas statutes sustained the Commission's assertion

of power. And this represents the view of an able and experienced circuit judge of the circuit which includes Texas and of two capable district judges trained in Texas law. Had we or they no choice in the matter but to decide what is the law of the state, we should hesitate long before rejecting their forecast of Texas law. But no matter how seasoned the judgment of the district court may be, it cannot escape being a forecast rather than a determination. The last word on the meaning of Article 6445 of the Texas Civil Statutes, and therefore the last word on the statutory authority of the Railroad Commission in this case, belongs neither to us nor to the district court but to the supreme court of Texas. In this situation a federal court of equity is asked to decide an issue by making a tentative answer which may be displaced tomorrow by a state adjudication (R. 499-500). See also *Beal v. Missouri Pacific Railroad Co.*, 312 U. S. 45, 49-50; *Watson v. Buck*, 313 U. S. 387, 402; *Chicago v. Fieldcrest Dairies, Inc.*, 316 U. S. 168, 171-173; *Texas v. Donoghue*, 302 U. S. 284; 54 Harvard Law Review 1379.

We respectfully submit that these considerations apply with particular force in a case such as this where not only are there present questions as to the interpretation and meaning of state statutes, but where the statutes involved are regulatory measures enacted pursuant to the public policy of the states to protect and secure their citizens dealing with companies selling securities, and where the questions also involve the title and right to possession of millions of dollars of securities now in the possession of the duly constituted officials of such states. Such a situation is indeed one where the federal courts might well "restrain their authority because of scrupulous regard for the rightful independence of the state governments and for the smooth working of the federal judiciary" (312 U. S. 501).

CONCLUSION.

We earnestly contend that the petition of the Debtor was not filed in good faith and should have been dismissed because: (1) the state deposits are not subject to the jurisdiction and control of the bankruptcy court, and without control of the state deposits there is no possibility of reorganizing the Debtor; (2) it is unreasonable to expect that a plan of reorganization of the Debtor can be effected; and (3) the interests of the creditors would be best subserved in the prior pending state court proceedings.

For these reasons we respectfully submit that the judgment of the Circuit Court of Appeals for the Fourth Circuit was correct and should be affirmed.

Respectfully submitted,

GUY B. BROWN,
H. VERNON ENEY,
Counsel for the Respondent,
John B. Gontrum, Insurance Commissioner of the State of Maryland.

APPENDIX A.

MARYLAND STATUTES.

The Laws of Maryland relating to companies selling installment accumulation contracts were enacted by Chapter 530 of the Acts of the General Assembly of Maryland of 1931, and are now codified as Sections 218 to 234, inclusive, of Article 48A of the Annotated Code of Maryland (1939 Edition) title "Insurance", sub-title "Installment Accumulation Contracts". We have printed below only the sections which are pertinent in this case and have shown only the descriptive title of the sections not printed in full.

Several of the following sections were amended in certain particulars by Chapters 121 and 639 of the Acts of the General Assembly of Maryland of 1941, effective June 1, 1941. The amendments are not pertinent in this case and have not been reproduced here.

218. (Definitions.) Whenever used in this sub-title the following shall be construed as follows:

The term "company" when used in this sub-title shall be deemed to include any individual, firm, partnership, association, trust, including a common law trust, corporation heretofore or hereafter formed under the laws of this State or any other State or territory of the United States or any foreign State or country.

The term "contract" when used in this sub-title shall include any bond, note, certificate, obligation, annuity agreement or passbook evidenced by writing, or other agreement to pay money.

The term "Commissioner" when used in this sub-title shall mean the Insurance Commissioner of the State of Maryland.

219. (Licenses.) No company shall hereafter engage or continue, either directly or indirectly, in the business of issuing, negotiating, offering for sale or selling any contract payable on the installment plan with or without definite maturity dates which contracts contemplate the accumulating of money or funds for making loans or investments and undertaking or agreeing to pay or deliver at any future time any sum of money, contract, or other thing of value, without first having obtained a license as provided in this sub-title.

Every company desiring to obtain a license under the provisions of this sub-title shall file with the Commissioner an application in writing in such form as may be prescribed by him. In case of a foreign company there shall be filed with the Commissioner a copy of its charter, declaration of organization or deed of settlement, if there be such, duly certified by the proper officer of its home state. Such foreign company shall also file with the Commissioner a power of attorney, appointing the Insurance Commissioner of the State of Maryland as agent or attorney for the company, upon whom process of law may be served, together in the case of a company having directors with a certified copy of the vote or resolution of the directors appointing such attorney. Said writing or power of attorney shall stipulate and agree on the part of the company making the same, that any lawful process against said company which is served on such agent shall be of the same legal force and validity as if served on such company within this State, and also that in the case of death or absence of the attorney so appointed, service of process may be made upon the Deputy Insurance Commissioner. Said power of attorney cannot be revoked or modified, so long as any obligations of the company remain outstanding in this State. The term "process" used above shall be held and deemed to include any writ, summons or order whereby any action, suit or proceeding shall be commenced or which shall be issued in or upon any action, suit or proceeding by any court, officer or magistrate. Every company

shall further file with the Commissioner a statement of the condition of the company on the 31st day of December next preceding.

Before a license shall be issued by said Commissioner, he shall make or cause to be made an investigation of the conditions and affairs of the applicant and its general plan of operation. If the Commissioner is satisfied that the company is sound and is being operated in such a manner as to afford proper protection to the holders of its contracts heretofore or hereafter entered into, he shall issue a license to said company authorizing said company to solicit, negotiate, sell and dispose of its contracts in the State of Maryland until July first next following, which said license may be renewed from year to year by the Commissioner upon payment by the company of the fees hereinafter provided for in this sub-title. If the Commissioner is not satisfied that the applicant company is sound or that it is being conducted in such a way as to afford proper protection to holders of contracts heretofore or hereafter entered into, he shall forthwith notify the applicant to that effect, and upon request from such applicant filed within ten days after receipt of such notice, the Commissioner shall fix a time and place for hearing, of which ten days' notice shall be given to such applicant, at which hearing the applicant may offer such information and evidence relating to its application as it may deem proper. If satisfied as aforesaid, as a result of said hearing, the Commissioner shall thereupon issue a license, but if the Commissioner is not satisfied, as aforesaid, then he shall refuse such license.

220. (Revocation of Licenses.)

221. (Right of Appeal.)

222. (Deposits Required.) No company licensed under the provisions of this sub-title shall at any time offer, negotiate, or sell contracts in the State of Maryland, unless and until such company *shall have assigned*

to and deposited with the Commissioner, or with some independent trust company approved by him, *in trust, as security for all the holders of contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued in said company in the State of Maryland,* bonds, coin or treasury notes of the United States of America, or interest or dividend paying bonds or stocks of this or any other State of the United States or of any county, incorporated city or other corporation of this or any other State having legal authority to issue the same and not in default, or other securities approved by the Commissioner, *having a market value of not less than $25,000, and at no time less than the aggregate contract liability of the company under all contracts heretofore or hereafter sold in the State of Maryland;* provided that in the case of a non-resident company which shall annually produce a certificate of the insurance commissioner or other proper financial officer of the State in which such company is organized, setting forth that such company has deposited with him securities having a market value of not less than $25,000 and not less than the aggregate contract liability of the company to the holders of all contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued by said company in the United States, and that he holds said deposit in trust and on deposit, under and by the laws of the State in which he resides for the benefit of all the contract holders of such company in the United States, and that he is satisfied that the securities so deposited by such company and held by him are worth not less than $25,000 and not less than the aggregate contract liability of the company to the holders of all contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued by said company in the United States, then in such case such company shall be excused from making the deposit hereinbefore required. When the value of said securities shall depreciate so that the market value of the deposit shall be less than hereinbefore required, additional securities shall be deposited in order that the deposit shall at all times be

maintained in the amount of not less than that hereinbefore required. (Italics supplied.)

223. (Exchange and Surrender of Deposits.) Any deposit of coin, treasury notes or securities as aforesaid made, may at any time be withdrawn by the company making the same, under such rules and regulations as the Commissioner may reasonably make, provided other securities authorized by law and of at least equal value shall be substituted therefor. Whenever it shall appear to the satisfaction of the said Commissioner with whom any deposit shall have been made as aforesaid that the aggregate amount of the liability of the company under its contracts heretofore or hereafter sold in the State of Maryland is less than the value of the securities so deposited, then to the extent of such surplus over the amount of $25,000, the said Commissioner shall permit said Company to withdraw a portion of said deposit. Whenever a company shall discontinue the negotiation or sale of its contracts in the State of Maryland, it shall notify the Commissioner in writing, and the Commissioner shall thereupon cancel the license of such company, and at any time thereafter upon the furnishing of proof satisfactory to the Commissioner that the obligations of the company under its contracts theretofore negotiated or sold in the State of Maryland have been satisfied in full, then said company may withdraw the deposit of securities required by this sub-title. If upon such discontinuance the company furnished proof satisfactory to the Commissioner that the liability of the company under contracts theretofore sold in the State of Maryland cannot in the future equal the amount of the securities deposited under the provisions of this section, then with the approval of the Commissioner the surplus over such possible liability may be withdrawn. If at any time this sub-title be repealed and a law be enacted in the State of Maryland governing the licensing, supervision and regulation of companies engaged in the sale in the State of Maryland of contracts of the kind and character covered by this sub-title, then the securi-

ties deposited under the provisions of this sub-title may be withdrawn by the company.

224. (Sale of and Income From Deposits.) All deposits made under the provisions of any of the preceding sections shall be held by said Commissioner subject to sale and transfer and to the application of the proceeds of any such sale only on the order of a court of competent jurisdiction. So long as a company shall be solvent and not in default under any section of this sub-title, it shall be entitled to receive the income from any deposit made under any preceding section.

225. (Annual Statement.)

226. (Publication of Revocation or Refusal to Renew License.).

227. (Examination of Companies.)

228. (Production of Books, etc.)

229. (Liquidation of Insolvent or Illegally Conducted Companies.) Whenever the Commissioner shall have reason to believe that any company is insolvent, or fraudulently conducted, or that its assets are not sufficient for carrying on the business of the same, or during any non-compliance with the provisions of this sub-title, it shall be his duty in addition to revoking the license of such company to proceed against it as provided by Sections 52 to 63, both inclusive, of this Article, for the liquidation of insolvent or fraudulently conducted insurance companies.

230. (Proceedings to Vacate Charter.)

231. (Fees.)

232. (Penalties.)

233. (Exceptions.) The provisions of this sub-title shall not apply to any company engaged in the business of issuing, negotiating, offering for sale or selling contracts wherein the liability under such contracts is adequately secured in advance of sale by the lien or pledge

with an independent trust company of property, real or personal, nor to any company engaged in the business of issuing, negotiating or offering contracts for the sale of securities where no payment is made to said company except upon the contemporaneous delivery by said company to or for the account of the purchaser of the securities agreed to be sold, nor to any domestic or foreign banks, banking institutions, banking companies, savings institutions, trust companies, safe deposit companies, insurance companies, building and loan associations, nor to contracts issued by a company for the purpose of raising money for its principal business, if its principal business is other than the issuing or negotiating or selling of contracts or obligations described in Section 219 of this sub-title.

234. (Severability Clause.)

APPENDIX B.

EXCERPTS FROM TESTIMONY OF DEBTOR'S WITNESSES.

D. A. BURT.

(R. 708-709):

The Court: I would like for you to go a little further and say what type of organization you have in mind, when you say that you believe it can be done. A. The first thing, of course, is to get a plan of such character that new capital can be obtained. If that plan is actuarily sound, and, as I said, meets the approval of the Securities and Exchange Commission and of the Auditor of this State, I think the capital can be found. If the general fund of the company is improved by the addition of a large amount of capital—and I admit that is a large amount—the contract holders are infinitely better off than they would be in the event of liquidation.

Q. Well, it is your idea that it should be continued as a face amount certificate company solely or some other form or a combination of more than one form of business? A. I don't know, Your Honor. It would seem to me a committee on reorganization would have to work that problem out with the supervisory authorities. I understand some of them object to that type of contract. If that is the case, the contract would have to be so modified as to meet their desires.

* * * * * * * * *

(R. 715):

Q. My point is this, Mr. Burt. I think your answer has given me partially the answer that I want, but you are not prepared to say, are you, that Fidelity should again engage in the selling of face amount certificates as a sole business? A. I won't answer that. That is a matter for the committee and the SEC and the Auditor to work out.

Q. And I say, you are not prepared to say that, in your opinion, it should engage in that business alone, are you? A. Not without a great deal of study.

Q. Which you have not—— A. Which I have not made.

* * * * * *

(R. 718):

Q. You answered, I believe, as I understood you, that you thought the present common stockholders ought to have some equities in the new company? A. Merely future earnings, if there are any.

Q. Sir? A. Merely future earnings, if there are any.

Q. What form would those equities take that you have in mind? A. Might take the form of——

Q. I can't hear you, Mr. Burt. A. I don't know whether the Investment Act would permit it or not, but I would think a no-par security of some sort.

Q. Voting rights? A. Yes.

Q. Voting rights. Will you speak out just a little bit louder. It seems to me like I am a little hard of hearing. Have you gone into the situation and are you familiar with the situation of this company with respect to deposits of securities in the different states—— A. No.

Q. (Continuing) Securing these contracts? A. No.

* * * * * *

(R. 720-721):

Q. Now, suppose, Mr. Burt, that under the laws of some twelve states other than the State of West Virginia there are, as I have put in my previous question, about ten million dollars of these assets being held to secure the liabilities of this company to contract holders who have their money in it, would you think that a plan that involved the cutting down or reducing of the claims of those contract holders—those secured contract holders—in those deposited funds would likely meet with their approval? A. There again you are getting back to the plan. Now, I am not going to discuss the plan. That plan will have to be worked out by a committee, and it

will have to meet the situation, and if it is approved, as I said, I think the contract holders in all the states will be so glad to have it, rather than a liquidation, that more than sixty-six and two-thirds per cent will approve it.

Q. I understand that you would agree with me that in forming an opinion as to the reasonableness and the prospect of a plan of reorganization, that we have to weigh the present situation with which we are dealing with respect to the assets of the company and how the assets are held. A. The committee will do that.

Q. You mean that you don't think that you should do that in expressing an opinion as to whether or not there should be a reorganization? A. No, I don't think so. This plan is in the air yet; it is not formulated; it depends on a great many factors, including state laws and national laws and the approval of supervisory boards, and I am not going to attempt to make a plan on this witness stand.

Q. I think you recognized that there was a need for a considerable amount of new capital? A. Yes.

Q. How much new capital do you think would be needed? A. I don't know. It changes from time to time; our securities list is up and down. We are at the moment in an advancing market. As soon as this tax bill is finally passed, investment funds will probably come out. There is a reasonable hope, at least, that securities will sell higher in six months than they are doing today. The portfolio might appreciate somewhat. I don't know what this committee might face.

Q. Do you know at the present time how much the deficiency is—— A. I do not.

Q. Well, wait. You haven't heard my question. A. Pardon me.

Q. Do you know at the present time how much the deficiency is between the reserves—invested reserves—and assets of the company—on the outstanding contracts—and the cash liabilities or reserve liabilities of the contract holder. A. I do not.

Q. Sir? A. I do not.

Q. You didn't know that that was about at least as much as $2,600,000? A. I did not. I understand——

Q. In your opinion, would there be a fair chance of reorganization, of getting the approval of the Auditor of the State of West Virginia and the Securities and Exchange Commission and two-thirds of these contract holders—these secured contract holders—to a plan of reorganization that did not bring up these reserves to the liabilities of the company, reorganizing it as a solvent company? A. There is again your plan. You are trying to get me to discuss the plan, which I will not discuss.

Q. Then you recognize that there is a problem of getting the new capital? A. Certainly.

* * * * * *

(R. 723-724):

Q. Did you own any contract at the time this company went into receivership? A. I don't know.

Q. Sir? A. I don't know.

Q. When was the last time you held a contract? A. I don't know that.

Q. Can you look that up and tell us? A. I don't know whether I can or not.

Q. How much did you ever hold? (No answer.)

Q. Well, I will ask you to do this. I see you are pausing—— A. I don't know. I had several contracts. Some I bought for my children and some for Mrs. Burt, but I can't tell when I bought them or what I paid on them.

Q. I want to ask you to do this, please sir. During the noon hour, to look up the information and then give it to us after lunch, the dates and amounts of all the contracts that you or any member of the family of you bought and the dates when you cashed them in, if you cashed them in.

Mr. Ray: Your Honor, that is an unreasonable request. Mr. Burt lives in Wheeling. Undoubtedly all his records are at Wheeling and I don't think those things have any place in this case at all.

Mr. Farmer: Could you get that for us, Mr. Burt?

The Court: Mr. Farmer, that would have pertinency only to the extent whether Mr. Burt owned any contract at the time of the receivership, and possibly whether he had cashed in any contracts before their maturity prior to the receivership. If you will confine it to that, I will admit it.

Mr. Farmer: I had in mind, if the Court please, it was a very practical test of his faith in this sort of savings institution.

The Witness: Not necessarily.

Mr. Farmer: I just thought that would be some test.

The Witness: Not necessarily. I might have needed some money.

Mr. Farmer: Well, can you get that information for us, Mr. Burt? A. I don't think I can.

* * * * * *

HUBERT F. YOUNG.

(R. 631):

Q. In your opinion, from your knowledge and experience with the operations of Fidelity and your general business experience, what is your judgment in reference to the feasibility of rehabilitating Fidelity through a proper plan of reorganization? A. I think it could be done and should be done.

Q. Will you explain that to the Court, please? A. Well, in my opinion there are two ways it can be done. One is by making an insurance company mutualized; the contract holders would own the company. One other way, the only way I know to have a face contract company, have a new company with new capital absorb the various contracts, with liability on a fair basis, to be arrived at by market value and liquidating value of the various funds; and one reason I think it should be done I think 1938 was the largest sales of any year we ever had. As I recall it, we went at the rate of fifty to sixty million dollars face value. Those people who bought then have not had an opportunity of paying long enough to get a

reasonable amount of money back on their investment. I think they should be allowed to continue to pay in, on a proper basis of course.

Q. What would you think about a third possibility of merging, say with an insurance company, and continuing to write annuity contracts but also engage in business in the general insurance field? A. Well, that would be my idea, if we had a mutual insurance company, except not to merge. I don't know what advantage we could show to some other company, just offhand, probably could—why they should merge with us.

Q. Could that be done either with a stock company or mutual company? A. I think that could be done with either, except in a mutual company you are giving your contract holders something for giving up something. I think we all know they will have to give up something, and they should be given some kind of compensation.

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(R. 671):

The Court: By the changes you speak of, do you refer, perhaps, to a scaling down of loading or some other feature that would render the expense of selling the contracts less and thereby increase the profits? A. I think that there would have to be a contribution made by the contract holders of the various series and especially the ones that are insolvent, and that the others should be asked to reduce the required amount presently required to redeem them.

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(R. 796-797):

Mr. Palmer: There is one other thing, I do not believe it was brought out by Mr. Young before that one of the requirements of the Investment Companies Act was a net capital of $50,000, and Fidelity, having no capital, but being minus a million and a half, it couldn't go ahead under that Act. A. That is the chief reason we couldn't qualify.

Q. Unless it got new capital? A. Unless it got new capital, but under present conditions that was the chief stumbling block.

The Court: How much capital? A. $50,000 in an old company. A new company requires $200,000.

Mr. Jaegerman: If the contract liabilities of Fidelity were reduced so it had $50,000 for capital, I suppose that would also comply, would it? A. It would comply, yes.

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(R. 799-800):

Q. Now, you talked about a plan that you had here, and as I caught it your plan contemplated cutting down these old contracts, these special annuity and special income contract holders. A. I didn't say I had a plan. I said that was one of the possibilities of working into a plan.

Q. You said first it might be made an insurance company. A. I said that is possible.

Q. Do you know any insurance company that would undertake to issue policies to these contract holders, who have not been selected on any basis of risk, either age or sex or physical condition? A. I didn't say I would give them an insurance policy. We would give them an insurance annuity.

Q. And cut down on the existing reserves that they have now? A. Possibly. Those are details.

Q. You would have to do that? A. Would you? Well, you answer that.

Q. You said you were going to cut them down about 20 per cent, didn't you? A. I didn't say I was going to cut them down at all. I said that was one possibility.

Q. Didn't you say by cutting them down to about 80 per cent it might be done? A. I possibly did, 80 or 70 or whatever it works out.

Q. If you will assume with me that there are some twenty million dollars of assets in this company, or better than that, which could be distributed among contract holders on the basis of their cash surrender values at the present time—cash liabilities at the present time—of about twenty-three million dollars, they could get that amount out of liquidation if you just sold them out and distributed the money, couldn't they? A. I doubt it,

after years of liquidation expense and the expense of litigation I don't think they would get anything like twenty million dollars.

Q. That would depend on court expense? A. Yes, and you don't know what kind of market you are going to have by the time you liquidate. It would take quite a while, in my opinion, to liquidate. It might drive the market down to the bottom when you start to liquidate, and instead of getting 70 per cent you might get 50.

Q. Those are conditions that you think might reduce the amount? A. Easily.

Q. But what you are proposing to do is to cut down these old contract holders whose contracts at maturity would have to be much lower than 80 per cent wouldn't it? A. Sure it would.

Q. And then invest the funds of this company in semi-speculative and speculative securities? A. Well, if they didn't they would probably lose their money some other way in my opinion.

Q. Did you ever hear of Mr. Ponzi? A. Yes, I have heard of him.

Q. He had his plan, didn't he? A. Do you think that is comparable to ours?

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EDGAR B. SIMS

(R. 454):

Q. Mr. Sims, let me see if I understand you. The structure of the company economically and financially was unsound from the beginning; is that right? A. Yes; they promised too much in the twenties.

Q. And never could have succeeded? A. Not at that rate they were promising.

Q. No matter about the extravagance or anything else; if run economically it was bound to be condemned; is that right? A. I think so. I think they were quarreling with Ray's arithmetic all the time back there; and there was another reason it was doomed to failure. They had bought German government bonds, Mexican bonds and

second mortgage bonds and fourth mortgage bonds, and of course, they are not worth much.

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(R. 455-456):

Q. And you said also that you would not license any company that might be built upon the corpse of this company to write installment contracts in West Virginia, did you not? A. That is what I said.

Q. Suppose the company was reorganized out of new cloth entirely. Do you feel that you would—— A. (Interposing). I just doubt——

Q. Just a minute, now. Supposing it was reorganized out of new cloth entirely, a reorganization that was authorized after this matter had gone through the Federal Court, under Chapter 10, do you still say you would not grant it a license to operate in West Virginia? A. I don't understand what you mean when you put that verb in the past tense, or the past perfect tense—"was reorganized".

Q. Well, I will say "will be reorganized". A. Organized by whom; and how much money will be put in it? I want to know that before I could answer that. I am not going to permit it to be organized on thin air.

Q. You can answer it or not, Mr. Sims. A. I think it inadvisable to relicense the company to sell these contracts exclusively. Twenty-six of the biggest insurance companies in the last five years have lost $66,000,000 on annuity contracts.

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(R. 457):

Q. Well, Mr. Sims, you filed a petition in the Circuit Court of Kanawha County, did you not? A. Yes, sir.

Q. You filed that under the statute which gave you the right to do it? A. Yes.

Q. In that petition, you asked for dissolution or reorganization, did you not? A. Yes, sir.

Q. You proposed, when you filed that bill of complaint, to reorganize the affairs of this association through the Circuit Court of Kanawha County? A. That was what I had hoped to do.

Q. Then you do think it can be reorganized? A. Not as an annuity company alone.

Q. Part annuity? A. I have serious doubts about the annuity business in any form.

The Court: How did you intend to reorganize it through the Circuit Court, Mr. Sims? A. I don't know; I am not a lawyer, Judge. I had hoped to work out a plan and submit it by mail to the contract holders.

Q. What sort of plan had you hoped to work out? A. Well, that was very thin and nebulous.

Q. Suppose you give it to us, however thin and nebulous it may be. A. I thought the company could be mutualized and turned over to the contract holders, give the stock to the contract holders; it ought to belong to them because there is nothing left there for the stockholders.

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ISAIAH SMITH.

(R. 480):

Q. Do you think it could be done? A. My personal thought?

Q. Yes. A. Without attempting to qualify as an expert, and without attempting to say what sort of plan, in my opinion with the assets the size that Fidelity has, a reorganization of some sort can be done.

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(R. 481-482):

Q. Now, with reference to reorganization, I think I copied your words down when you said you believed reorganization of some sort can be done. Is that substantially what you said? A. Yes, that is a pretty broad term, I expect.

Q. Now, you have had some two months' experience as a state court receiver, and have had approximately the same time as an employee of the trustee in this proceeding, is that not right? A. Yes.

Q. As such you have had some little chance to study the working of Fidelity although your main employment

has been in trying to gather the various funds together and to get reports up on them. A. That is right.

Q Now, when you say reorganization of some sort can be done, you are using that purposely in a very broad sense, are you not? A. I am.

Q. You are not attempting to state you believe there can be 66⅔% of the creditors or contract holders, either as a whole or of any one class, who can or will agree to any specific plan, are you? A. Of course, I could not answer that question without knowing something about the plan. I don't know what they are going to do, and even any kind of plan we might finally think is good I don't know who will accept it and who will not.

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RAYMOND LATTA.

(R. 1105-1106):

The Court: I will sustain that objection in that form. I will ask the witness this question, however, which I think will cover the situation, as I see it.

Q. Mr. Latta, is it possible to construct an actuarial plan of reorganization for Fidelity? A. Yes.

Mr. Palmer: In your experience, Mr. Latta, would that actuarial plan work?

Mr. Ray: Oh, that is the same thing in another way, trying to get the witness to answer something the Court has ruled he is not qualified to answer.

The Court: Sustained.

Mr. Palmer: I will have to make an offer upon the record, your Honor.

The Court: All right.

Mr. Palmer: The witness, if permitted to answer the question, would state that it is unreasonable to expect a plan of reorganization can be effected for Fidelity. The witness would further say, if permitted by the Court so to testify, that Fidelity itself can never be reorganized as

a going concern, either as a face amount certificate company or as a life insurance company. If the Court would permit, I would like the witness to be permitted to state his reasons why Fidelity can never be reorganized and operated as a face amount certificate company and as a life insurance company, those reasons being based upon his experience and actuarial knowledge. I ask the Court's permission for that.

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(R. 1110-1111):

Q. Mr. Latta, will you please explain your answer to the Court's question when he asked you if Fidelity could be reorganized actuarially—I don't know the exact question, but you answered the Court's question "Yes". Would you explain your answer, please? A. Actuarially whether it could be reorganized strictly from a mathematical viewpoint, as I interpreted his question to be, would be as to whether there could be computed, as far as figures are concerned, in order to place this company in a solvent condition, ready for operation on a sound financial basis as of that time. That is my interpretation of what he meant.

Q. Would it be possible to answer the Court's question by saying, "We will take from each contract holder forty per cent or place a forty per cent lien upon each contract holder," work that out actuarially, and then you would have the company reconstructed actuarially upon a sound basis? Would that be possible?

Mr. Huwe: I object to that question.

The Court: Overruled.

A. It would make the company solvent, but it wouldn't be reorganized on a sound basis, no.

Mr. Palmer: Beg your pardon? A. It would be solvent at the time provided the forty per cent was sufficient. You could make the company solvent, but that doesn't make it sound from an operating viewpoint, actuarially or otherwise.

Q. What would you do to do that? A. Well, as far a plan of reorganization was concerned, you would have to make the entire construction of the company so that the future operations could be done on a sound basis—could be carried on on a sound basis. By a sound basis, I mean as far as being able to meet the obligations when they may become due as specified in the contract.

Mr. Palmer: In other words, whether or not you could possibly construct an actuarial plan for Fidelity and your answer to that bears no relation to what your answer would be as to whether Fidelity could be successfully rehabilitated, is that correct? A. They are entirely separate questions.

Q. And bear no relation to each other? A. No.

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HOWARD E. REED

(R. 736-737):

Q. Mr. Reed, from your business experience in the past and from your knowledge of Fidelity and the character of its business, will you state whether or not, in your opinion, a plan of reorganization of Fidelity can be developed which will be practical and feasible? A. I think it can.

Q. Do you care to make any statement of your reasons for your answer? A. Well, of course my reasons are purely from the sales standpoint. I think that there is a great field in this country for an income contract—an income reserve contract. I don't believe that we have scratched the surface in systematic saving in this country. We are today reputed to be the greatest savings nation in the world, but the per capita savings as of June 30, 1940, were $196. So that there is yet a tremendous field for this business which has not been touched. Mr. Carpenter told me in Cleveland that he had made twenty-five interviews that week and in no instance did any man whom he interviewed mention defense bonds, so that we feel that there is still a great field for this business regardless of any so-called government competition.